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AUSTIN H. CARR, Editor,
10 Adelaide Street East, Toronto

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(The opinions expressed in articles in The Canadian Chartered Accountant are the opinions of the writers of the articles and are not necessarily endorsed by the Association.)

Editorial Comment

New Members

The provincial Institutes have come to regard the admission of new members as an important event of the year, and, according to the "Provincial News" column this month, some make it the occasion of their annual dinner. For a profession that is receiving annually—and to an unprecedented extent during the present war—a barrage of calls for qualified men to fill responsible posts in government and in industry, this influx of new members is a welcome addition to the ranks. For the successful candidate in the final examination, graduation is more than an everyday experience. He feels and has a right to feel that he has reached an important milestone in his life. A five years' period of directed study and supervised training in the office of a chartered accountant has just been completed. As time passed he had begun more and more to realize that these years of apprenticeship and discipline, though arduous ones, were a very necessary preparation for duties and responsibilities lying ahead. Not until he is "on his own" will the young chartered accountant be able to appreciate fully the importance of that training and to acknowledge the significance of the acquired qualities of thoroughness and unbiased judgment which along with integrity are the keystones in the building of a successful professional career.

The standing of the profession of the chartered accountant throughout the British Empire is one of which members can well feel proud and which individually they must diligently protect. There exists a high standard of professional ethics throughout our Dominion, and at intervals it is good for the individual, with the standard before him, to turn the searchlight upon himself. Everyone who had the privilege of hearing the address of C. Fraser Elliott, K.C., Commissioner of Income Tax, at the annual dinner of the Ontario Institute must indeed have felt newly inspired for meeting the responsibilities and problems which have become his daily lot. The editorial committee is gratified that the address can be published this month and thus made available to readers throughout the Dominion. The committee is also glad that the words of sound advice to new members given at the dinner of the Quebec Society by its President, H. G. Norman, are also published in this issue.

What Examinations Cannot Test

At this point we want to add a word for those who did not succeed in passing the December Final examination. Some there are who do not take their studies seriously and so deserve to fail; there are the others however, and they are well in the majority, who have pursued their studies with diligence and yet have not reached the stage at which independent examiners can adjudge them worthy of admission to the profession of the chartered accountant. It may be said here that, because of the standard of qualifications required, we do not know of any more exacting test than this examination. It is no disgrace not to pass it at the first attempt; failure to pass should serve as an urge to further study and research, and we wish the faithful ones success in the mid-year Final examination next June which, according to an announcement appearing elsewhere in this month's issue, the Board of Examiners-in-Chief of the Provincial Institutes has arranged for all candidates eligible to write at that time.

Following any qualifying test there is the usual list of prize winners. All successful candidates cannot stand at the top of the class, but that must not be considered a handicap. In this land of freedom and of unlimited opportunities there is little room for alibis; it lies largely within the heart and mind and will of the individual what he shall make of his

life. Throughout the years we have oftentimes been amazed yet thrilled at the success that has come later to those who on leaving school or college had been classified by examinations as mediocre. The real test came when individually they found themselves facing the world alone. No academic examination can measure the determination and the will to overcome difficulties. Let him who doubts this statement read the history of all great leaders, and let him not fail to include in that list the inspiring account by Kraus of the life of one of the world's greatest men of today, the Right Honourable Winston Churchill.

Are You Only A Prize Seeker?

We mentioned the prize winners. It is a sad commentary indeed on our educational system and method of testing qualifications that little is heard from the long line of examination prize winners following the day when, with the applause of their fellows, they walked away with a medal or a prize. We can count on the fingers of one hand the names of all such graduates during recent years who have continued to pursue their studies and have given their fellow members the results of their thought and research in particular fields of study.

The profession of the chartered accountant in Canada is today only in the elementary grade or at the introductory stage of its development. No one is able to tell or describe its broadening future. This we do know that the profession will be needing leaders stalwart of heart and sound in the quality of judgment that comes from patient observation and never-ending study of its problems. To all young men who have lately entered our profession and can sense its future even in some degree, we say, keep not your talent "hidden away in a napkin." Seek inspiration and you will find it.

Contributing to the Profession

This prompts us to refer to a matter mentioned before in these pages which we shall not cease stressing in coming days. The editorial committee asks you as members to let others know what you are studying and thinking about. From his daily practice and constant solution of problems and from his selected reading and recorded observations, the leader, in embryo, of the profession of to-

morrow will be accumulating a mass of reference material for studies close to his heart. Possibly he has not given any consideration to their publication. Judging from the extent of past receipts of articles from members, we know that he has not. If you are of the opinion that contributions for publication in THE CANADIAN CHARTERED ACCOUNTANT must be prepared within a brief time limit, we want to correct that impression. All studies worth while are not done hastily; they may extend over months and longer. As in wine, there is an aging process. The member-student, engrossed in his subject and adding instalments to his coming finished product reads what he has already written and will be astonished at the new thoughts that have come to him during the intervals between instalments—all of which goes to show that his subconscious mind had been busy sifting, assimilating and rejecting to an extent of which he was not aware. Finally comes the day when the product is ready for publication.

The editorial committee invite members to put their spare time to profit for the profession, and will welcome receiving the letters of all who may wish to consult them on proposed articles. And the member-student should not forget that the greatest profit from his study and writing after all comes to himself.

(The following comments have been contributed)

War Appropriations Bill

The war appropriations bill just introduced into the Dominion House of Commons by the Minister of Finance should provide a shock for the serious minded. Briefly, it provides for a war expenditure in the fiscal year 1941-2 of approximately \$1,450,000,000—that is, about one-third of a national income estimated at \$4,500,000,000. In other words, through loans or extra taxes one-third of Canadian incomes must be taken for war expenditures. Of course the incidence will not result in every person paying one-third of his income; some will pay more and some less, for it is both difficult and inexpedient to take one-third off the very low incomes. The allocation of the war expenditure cannot be given in detail, except to say that the army gets some \$667,000,000, the air force about \$386,000,000, the navy \$170,000,000, expansion of industry \$178,000,000, and var-

ious minor projects the balance. These seem like very sizable sums of money, especially when they are compared with other expenditures. Until the budget is brought down it is only possible to say that it means increased taxation the exact form of which is not clear. In addition to these war expenditures, the Dominion government will require approximately $450,000,000 for general purposes with the result that its total expenditures will be in the vicinity of $1,900,000,000. Further in addition the provinces will spend roughly $260,000,000 and municipalities around $300,000,000. Thus all governments combined will take from Canadians some $2,500,000,000 which even if the national income should reach $5,000,000,000 would mean that fifty per cent would be levied for government purposes. The implications of this in reference to the consumption standards of the population are rather appalling.

War Finance

The real problem in war finance, which cannot be stated too often or emphasized too much, is that of restriction of consumption so that goods and services ordinarily consumed can be directed to military ends. Or to put it another way, the economic resources of the country must be diverted to production of goods and services for military purposes. So long as a nation has idle resources—plants, men, etc.—these can be drawn into the production of military supplies or be used to release other forms of wealth for this purpose. But once they are all employed it becomes necessary to restrict consumption and substitute less effective resources. (The latter means, for example, drawing in women workers, older and younger people; in addition, a greater dilution of skilled workers may be tried.) Many people are inclined to think that the purpose of taxation is to provide the government with revenue, which is quite true. But an even more vital thing is that taxation restricts consumption and thus releases economic resources for direct war production. The same is true of loans—in the form of either bonds or savings certificates. Quite obviously some forms of consumption need not be restricted although the particular forms may differ from country to country. In England, for example, fruits such as apples are imported and therefore must be restricted, but in Canada apples are abundant and, within limits, the orchards (but not all the labour) are good for

nothing else but apple production. This necessity to refrain from drawing on the country's productive resources is one of the greatest contributions that the individual citizen can make and if fully understood would be accelerated. Unfortunately, there is still in the Dominion a considerable amount of "boom" psychology which can do much harm. In general this war means a reduction in consumption standards and the sooner this point is grasped the sooner will the people of Canada be serious about the war.

Practising Own Precepts?

This is the time of year when municipal budgets are being presented to the various councils and the large number of reductions in the tax rate is gratifying. Most of these reductions have been made possible by economies —in particular, in unemployment relief—and by reductions in bonded indebtedness. In this connection it is of more than ordinary interest to note that municipal governments are the only governments in Canada which are forced to maintain sinking funds and to provide regularly for the retirement of their debt. The requirement is thoroughly sound and proper, but even the obvious gains of the policy have not been sufficient to induce provincial governments (which insist on the requirement for the municipalities) themselves to become self-denying to the point of practising their own precepts.

TAXES AND RELATED MATTERS*

By C. Fraser Elliott, K.C.,
Commissioner of Income Tax, Ottawa

AN annual dinner is not a suitable place to discuss a technical subject in a technical way. It is not a place to interpret the difficult and weighty passages of the law. Further, taxes are not in themselves humorous. So you perceive the occasion and the subject are rather strangers. If a technical discussion were desired we should meet, not with full stomachs and satisfied minds, but with hungry stomachs and keen minds.

Some there are who come in the hope of a new ruling, or a momentous pronouncement, or a great disclosure of how they might avoid, though not evade, taxes. They will be disappointed. Some there are who come to make my acquaintance as Commissioner, and welcome indeed are they. I shall try to be on my best behaviour, for traditionally tax men are supposed to be stern. Some there are who come because they are friends of mine; thrice welcome they are—once for me, once for them, and once for the kind support on this occasion. Some there are who come—and these are by far the most—because it is the annual dinner of the Institute of Chartered Accountants of Ontario. They come as a matter of loyal support to the organization, though the devil himself were to speak on Christianity at large and not taxes in particular.

Actually I intend to proceed mildly, with some reference to the past, but more particularly to the present, with, I hope, engendering some abiding incentive to carry on the developing intensities of our work.

But yesterday, a tolerated topic of conversation was "my operation" or any stock market operation. Today it is "Our War" and "My Taxes." Such subjects are really not pleasant, although they are of intense interest to the party concerned.

War and taxes are evil companions. Each must be managed with consummate skill. They are declared by the free will of the people. They must be supported by the will

*An address delivered at the Annual Dinner of the Institute of Chartered Accountants of Ontario in the Royal York Hotel, Toronto, 28th February 1941.

of the people if the great enterprise of maintaining our way of life as a free people within the British Empire is to continue. "War" conjures up men as *citizen*-soldiers arranged and regimented in their millions by Red Caps and Sam Brownes. "Taxes" conjures up "money" as *dollar*-soldiers recorded and regimented in their millions by ledger-men and pen-men.

Soldier-citizens and soldier-dollars are equally important. They are interdependent. With equal clarity and certainty, the one must be ordered and the other tabulated.

Without proper records, without accurate accounts, chaos would ensue. You are the professional accountants. The records substantially all come under your control and your direction. You must certify as to the accuracy of the important multiple accounts of the nation. The fruits of labour, skill and knowledge are allocated between taxes, profits and dividends following your "certification." Of that I shall speak again.

Rising Tide of Taxes

War and Taxes became evil companions or partners in Canada about 1916 or 1917. Meanwhile, War became a sleeping partner while Taxes took on weight. As it was in Canada, so it was throughout the World.

Today, we reckon anew with the monsters! Let me indicate the rising tide of income tax. In theory and form, income tax is very old; in weight and social effect, it is very new. Historically, income tax has been known for many centuries. But it was an innocuous thing compared to 1914 and thereafter. Its theories and possibilities were well known; its weight was comparatively negligible.

1450—As early as 1450, there was an income tax in England. Furthermore, it was graduated—6 pence in the £1 on incomes between £5 and £100; 8 pence in the £1 on incomes over £100; i.e. 2½% to a high of 3⅓%—a terrible burden for sure even if adjusted to changed modern income values!

1800—About 1800, for a very short time, the highest rate was 10%.

1842—In 1842, it arrived to stay, but was nevertheless introduced as a "temporary measure," just as in Canada in 1917—a temporary war measure!

1909—In England, about 1909, or 67 years after its introduction, Lord Asquith declare it to be "an integral and permanent feature in our financial system." In Canada, about 1920, we knew it to be a permanent feature; our temporary hopes had disappeared in three years.

1910—In 1910, the rate of income tax anywhere in the world was not above an effective rate of 10%. The United States constitutionally had none; they were just beginning.

1920—By 1920, brackets of 65% and higher were common; nevertheless, the effective rate was relatively low, that is, relative to the 1940 effective rates.

1940—Combined taxes of the weight of 1940 and thereafter are entirely new in the world. They are creatures of our own times, that is, of lives in being, without the twenty-one years.

Dominion corporation taxes have steadily moved from 8% in 1929 to 18% in 1939; they are now 30%, and if there are any excess profits, the tax may be 75% of the excess, with provincial taxes to be considered as well.

By reason of the combined effect of corporation taxes including taxes on excess profits, and individual taxes on dividends, the Crown today, generally speaking, appropriates more than is available for shareholders of an expanding business. You are all familiar with your favourite example.

It is of such heavy taxes and your responsibility to the Crown and to your clients, and of our joint responsibility to the people, that I wish to speak to you as a section of the professional accountants of the world—The Institute of Chartered Accountants of Ontario.

It is my desire and the desire of the staff of the Income Tax Division to be ever more closely associated with you and all professional accountants—individually and collectively, for the Dominion administers the income tax laws not only of the Dominion of Canada, but of the Provinces of Manitoba, Ontario, Quebec and Prince Edward Island and of the District of the Yukon.

Incidentally a recent dream of mine of being forestalled of heavenly entrance was overcome by the fact that, by remote control, I administered a district, namely the Yukon District, in which I had never been, had never met the taxpayers, and was removed therefrom by many, many thousands of miles. St. Peter said "Come in, you are the

man we want. We have no trouble in Heaven and but for a special condition we certainly do not want you, but the fact is, we are having a hell of a time collecting toll from the district of Hades, and your remote control methods sound good. The trouble is that that place is full of accountants." I took the job so that we might continue in our related work in our related positions. I woke up greatly refreshed.

May the oncoming intensities of accelerated business, of war accounting and of taxes enhance our mutual esteem and trust.

Three Phases of Dominion Income Tax

The first phase of Dominion income tax is from 1917 to 1935. The collections of income tax were in that period about sixty million dollars yearly. Although the national income varied, likewise did the exemptions and the rates, so that the yield was stabilized at sixty million dollars per year.

The second phase is indicated by a constant twenty million dollars annual increase of revenue from 1935 to 1939, as follows:

1935	$ 60,000,000
1936	80,000,000
1937	100,000,000
1938	120,000,000
1939	140,000,000

In 1940 the new war budget introduced the third and dramatic phase along with the national defence tax and the excess profits tax.

Combined, these three will raise a revenue on average of over a million dollars a day. This direct tax revenue of over $365 million per year will come out of an increased national income in 1941 estimated at $5,400,000,000—that is, direct taxes will take approximately 7% of the national income.

General Developments of 1939 and After

May I indicate in general terms the developments in 1939-40, much of which administratively actually took place within the space of a few months.

Capital Expenditures; Tax Credit—At the beginning of 1939, business was at such a low ebb that it was thought advisable to stimulate it by offering 10% of all capital expenditures made in Canada within one year as a deduction from tax, the 10% tax credit to be spread over three years. This was in May 1939; the offer ended at May 1940. The war intervened but the offer could not be withdrawn.

Expenditures made and tax credits claimed thereby are as follows—

Out of approximately 15,000 tax-paying corporations, 3,272 corporations expended $142,000,000 for a tax credit claim of $14,200,000; 619 individuals expended $4,000,000 for a tax credit claim of $400,000; or in all, 3,891 taxpayers spent $146,000,000 and claimed $14,600,000 in tax credits.

These records required special segregation by accountants in the books of account of the taxpayer, else they would not be allowed. They are yet to be assessed and approved by the assessors of the Crown. Our joint efforts will be required to conclude the claims; we will rely heavily on the "certificate" of the professional accountant.

National Defence Tax—In June 1940 there was imposed the national defence tax.

Our individual taxpayers, prior thereto, under the general law, numbered approximately 270,000, not to mention the large number not assessable because of temporary insufficient income or income just below the statutory exemption. Due to the lowered exemptions, the number filing returns this year will be well over 500,000. The national defence tax increased the number of taxpayers to well over 1,250,000. They became active tax contributors five days after the law was passed by Parliament. To secure appropriate exemptions, returns were required to be filed with their employer before the next ensuing pay day. Over 60,000 employers were required to deduct, report and remit the taxes collected at the source. At the present rate of 2 or 3 per cent, the revenue therefrom will be about $35 million per year.

As corporations received returns from the employees, clerks became assessors, taking into account marital status and dependents, and thereupon determined the tax payable. They deducted the tax from the pay and held it as trustee until sent to the Crown. The Crown issued its receipts.

Monthly remittance by 60,000 employers, in each of twelve months, means 720,000 ledger entries per year, together with all the receipts and attendant business details. Thereafter, segregation of the tax, in most cases, to the credit of the particular taxpayer—employee was required. Over 16 million necessary forms were immediately produced to put the Act into speedy mechanical operation in accordance with the law. Thus were the incidents made known publicly and the instruments of compliance distributed, together with appropriate informative brochures.

Finally, after the close of the year, every person from whom deductions had been made must be reported upon by the company, not only for general checking purposes but against the day of possible refund claims—claims that may be made by many thousands of persons.

This meant that taxpayers who were also employers had to be considered in two capacities—the one on account of their own taxes, and the other for taxes deducted from their employees and remitted as trustees. This more than doubled our corporation tax-roll, for many institutions are employers though not themselves taxpayers. Then, every dividend payment to every recipient in Canada, no matter how small the amount, and likewise every registered interest payment required a deduction to be made and the same procedure followed.

Your profession will, in the course of your usual duties, be required to certify as to the accuracy of the accounts of public corporate employers in the discharge of this statutory trusteeship duty, the same as you do for all accounts. But the point is, it is another of the cumulative duties of a tax character arising in the course of your duties and functions. The cost of compliance is mounting!

Instalment Payments—Then, in September 1940, the instalment plan for payment of income tax was announced. Over 110,000 persons adopted the plan to pay one-eighth in each of eight successive months. That means that about 900,000 entries are required where formerly 90% of the taxpayers paid in full in April, or at most by two instalments. The change to instalments was occasioned, among other reasons, by the heavily increased burden. This means added accounts not only for the Income Tax Division but also for the business world itself.

Income Tax Staff—I divert, incidentally, to assure you and the public that this mounting volume of revenue, information and internal work from 1930 to 1940 did not occasion an equivalent increase in staff. Far from it. By reason of appropriate internal changes and economies, our staff did not increase until after October 1940. The staff at all times—from 1930 to 1940—was very approximately 1300. Recently, it has been substantially increased to about 1650, at which number it stands today. Meanwhile, the cost of collection has declined from 3.1% in 1930 to 1.7% in 1940.

We collect well over 99.5% of the taxes assessed. We are not aware of any who should be assessed, not having been assessed.

The Excess Profits Tax Act, 1940—In June 1940 there was introduced the present excess profits tax estimated to bring in over $100,000,000 in twelve months of operation. This measure affects vitally some 6,000 companies. Combined with the income tax, it takes 79.5% of the income over the standard profits. It has the two major divisions, namely, What is the capital employed? and, What is the income base? The annual quantum of income is determined under the *Income War Tax Act*. The two stated divisions are replete with difficulties; indeed many persons, and your own Dominion Association of Chartered Accountants, by written memorandum, called for appropriate amendments. No doubt amendments will be made.

Profession of the Chartered Accountant

Accounting problems under this measure are many and diversified. Business men will call upon the accountants as never before. The Crown and all patriotic persons will expect an initial factual determination of capital and income by the accounting profession that is at once as skilful as it is just. Your "certification," you appreciate, assumes a position in the affairs of the nation today quite beyond its important place of a few years ago. The Immediate Past President of your Dominion Association, Mr. Dalglish, tells me that in England the Revenue officials practically accept the report and certification of the chartered accountants on questions of fact pertaining to the accounts. That is a splendid recognition of the high standard there attained and of the virtues of the profession and its personnel.

In that regard let me indicate that in law, secondary

evidence is rejected if primary evidence is available. Primary evidence is the book of original entry and the evidence of the person that made it. However, your profession very often in court and always before the Crown, gives secondary evidence as if it were primary evidence. It is relied upon without question and without oath, simply because of your high standard of professional skill and ethics.

There is every reason to believe that such trust and confidence as exists in the United Kingdom is developing in Canada. Such a trust is not created by a declaration. It is acquired by a course of conduct over a long period of time. It is not a thing given or taken. It is a thing that grows in the course of time. It is an understanding amounting to complete trust and reliance in the integrity, the honesty of purpose and ethical standards each of the other; further that there prevails a steadfast purpose to adhere to such characteristics notwithstanding special pleas or inducements from any source to deviate therefrom.

Our direct taxes are, comparatively, so very new, as also are some professional accountant associations, that it is perhaps too early to consider that we have attained to such perfection and mutual understanding as they have in England.

But let me return to the facts that indicate the magnitude of the yearly transactions over which your profession exercises supervisory direction and control.

The Dominion Bureau of Statistics advises me that the gross revenue for 1938 of all industries in Canada, including the Government, was approximately 15.4 billions of dollars, of which 4.25 billions represent the national income, and 11.15 billions represent salaries, wages, overhead, materials and depreciation.

As stated, a total of $15.4 billion was the gross revenue of Canada for 1938. Further, the cash and cheque transactions of 1938 amounted to 38 billions of dollars. These figures, I repeat, are mentioned to indicate the extent of the accountancy work required to maintain the orderly continuity of the transactions involved.

While it is not the business of the professional accountant to enter such records, I understand he makes it his business to install the system, to supervise it, to check it and finally to certify as to the results as represented in assets and liabilities, profits or losses.

Channels of Dollar Movements

Now what are the main supervised channels of the dollar movements? Dollars are directed to the government by the increased income taxes, the national defence tax, the excess profits tax, the instalment payments at the end of the month, the national defence tax remittances in the middle of the month, while dollars are directed from the government by the special capital expenditure allowances.

Dollars are diverted to the public by the ever increasing war expenditures, cost plus contracts and corporate management fee costs, purchase of capital permanent structures—capital equipment and war supplies of every kind, while dollars are diverted to shareholders from the results of the general upswing in business.

These movements have placed the dollar-soldier in Canada vigorously on the march to victory. His regimentation, his divisions, his income and capital units, his credit and debit columns and the results in general came and continue to come largely under your professional direction and supervision. You must keep the dollar-soldier in his properly regimented place at all times. You must close up the ranks annually. You command a greater number of dollar-soldiers than the generals command citizen-soldiers. They may have their millions but you have your billions. Your dollar-soldiers must be mobilized, manoeuvred and brought to the orderly attack with no less organization, skill and certainty than the citizen-soldiers.

New Graduates

You have admitted tonight a number of graduates. May I say a word to them and to the members generally.

Gentlemen, we have and shall continue to have much work in common. Indeed in our work we have many members of your organization. We are in need of more; for governments in many directions are dependent upon professional skill for their successful and efficient operation as never before.

Tax laws have enlarged the scope of the chartered accountant's professional career. It has intensified his functions and increased his importance in business and governmental circles. We deal in the recorded results of other men's labours; from the fruits of their labour according to

the "certified" record, the Crown receives its taxes,—and the proprietor declares dividends.

The nation and the business world look confidently upon this procedure from year to year and tacitly state, "All is well," for the professional accountants have "certified" it to be so. The business world stands suspended as to results pending the "certified" annual statements of its year's activities. It is a substantial task; it is a great trust. By the splendid discharge of that trust you establish the reputation of yourselves, your profession and your nation. Individual action cumulatively establishes the citizenship characteristics of your profession. Reputation established through good citizenship is more to be desired than through material things, important as they are made to appear in this address.

The greatness of a nation in territory may be measured; the finances and revenues may come under accurate computation; the population may be numbered, and all these things tabulated by cards and reflected on charts and maps, but there is nothing in national affairs more subject to error than the right valuation and true worth concerning the power and force of good citizenship. The earth may be compassed, but not man. The kingdoms of the world may be measured and tabulated but all the King's horses and all the King's men have neither the wit nor the wisdom to measure the good citizen within our midst.

The basis of good citizenship is work. It gives an outlet from sorrow, restrains wild desires with the fatigue of honest toil, ripens and refines character, fosters the co-operation of man with man and each with the Divine Power, and when well done brings to life its consummate satisfaction.

Deliver me from conforming to full measure of my own injunctions. We hitch our wagon to a star, yet move among the planets. As Shakespeare said, "I can easier teach twenty what were good to be done, than be one to follow mine own teaching."

However I dwell on the value of "work" as a basis of good citizenship and as "A Song of Triumph."

Work!
Thank God for the swing of it,
For the Clamouring, Hammering ring of it,

Passion and labour daily hurled,
On the mighty anvils of the world.
Oh, what is so fierce as the flame of it?
And what is so huge as the aim of it?
Thundering on through dearth and doubt,
Calling the plan of the Maker out.
Work, the Titan, Work, the Friend,
Shaping the earth to a glorious end,
Draining the swamps and blasting the hills,
Doing whatever the Spirit wills—
Rending a continent apart,
To answer the dream of the Master heart.
Thank God for a world where none may shirk,
Thank God for the splendour of work.

—Angela Morgan.

VARIABLE BUDGETING AND THE CONTROL OF MANUFACTURING EXPENSES

By Alan W. Bell, M.B.A., Montreal

OVER the past number of years, there has been a tremendous growth in the interest which has been given to budgets and budget techniques. The growth in the size and complexity of business makes it more and more difficult for the top executives to control the activities of all the departments of their companies. Management has found it necessary to develop some means for controlling and coördinating sales, production and financial activities to the end that the company will have enough and only enough of the right goods on hand at the right time, without at the same time increasing its costs disproportionately or prejudicing its financial position. Even so, it was not until the prosperity of the 1920's gave way to the narrowing margins of the 1930's that a real impetus was given to budgeting. Direct labour and material costs presented their problems to be sure, but the real difficulty was found in attempts to control manufacturing expenses or overhead. The typical picture was a slashing of expenses followed by a gradual 'creeping-back' and then a further slashing. Obviously this was not only disturbing to the morale of the workers and supervisors, but it was at best a belated cure. It attempted to apply a remedy after instead of before the expenditures had been made.

The first step in the development of budgeting came with the fixed or annual budget. A budget of expected sales for the coming year was made up and broken down by products. An inventory policy was decided upon with reference to the finances of the company and then a production budget was made up by months. The latter budget was then broken down into its components—material, labour and overhead. As a device for controlling expenses, this sort of a budget is wholly inadequate. The actual volume of sales will usually be sufficiently out of line with the budgeted estimates to make comparisons of actual and budgeted expenses rather meaningless. It is true that variances could be analyzed and broken down, but the trouble here is that by the time the analysis is made, the operating men have forgotten all the details of the transactions. Also, when adjustments are made in a budget after the expenditures have been made, they are bound to be unreliable and biased. Finally, this kind of a budget does not give the operating men a reliable guide as to what their expenses should be at the actual volume of production then prevailing, and it is therefore of little use in helping to plan the day to day production.

However, the inadequacy of the fixed budget does not provide an excuse for scrapping it. It is a prerequisite to proper coördination and control of the sales, production, and financial activities of the business. By planning future operations in the form of sales, production and financial budgets, we obtain a picture of the company as it will be if the plans are fulfilled, and if this picture does not please us we can change or at least reconsider our position. What we need is not to do away with the fixed budget altogether, but to supplement it with some device which will be of use to the "men down the line." It was to supply this need that the variable budget technique was developed.

What Is a Variable Budget?

The principle behind the variable budget is that for any given volume of business there should be some norm of expenditures, and this norm should be known beforehand so as to provide a guide to what expenditures should be before they are incurred rather than after. Whereas the fixed budget is a device to assist in planning the general policies of the company for the coming period in terms of a given volume of business, the variable budget has as one of its

main objectives the maximizing and control of profits for whatever volume of business is actually obtained. This applies equally to material, labour and overhead cost control, but in this paper the attention of the reader will be confined to the variable budget as applied to the control of overhead expenses.

Establishing the Budget

It will usually be found desirable to place the budget under the control of an assistant to the president, or to someone responsible directly to him. This will avoid possible friction between department heads which would arise if the budget director was a subordinate officer on an equal rank with all the department managers. Furthermore, since there is bound to be interdepartmental disputes brought to light by the use of the budget, and since these will eventually have to go to the president for solution, it is best that they go directly to him or his assistant rather than through some subordinate. A budget committee will usually be formed consisting of the chief functional officers. All departmental estimates will be considered by the committee, and no estimate will be made final without the approval of the committee.

The next step is the working out of the actual budget procedure. In the case of manufacturing expenses this may be conveniently discussed under seven headings: (1) Education and personnel problems, (2) Setting up spending or control areas, (3) Determining a measuring stick of productive capacity, (4) Studying the behaviour of costs, (5) Adapting the accounting procedures to the budget, (6) Form and presentation of reports, (7) Analysis of variances.

Education and Personnel Problems—In the first place it must be remembered and emphasized that the co-operation of the chief executives is essential if the budget is to be a success, and anyone who would like to introduce these techniques into a company must remember that the more prosperous or more liquid a company is, the more difficult will it be to interest executives in any such schemes. In such cases it becomes all the more necessary to direct attention to this educational problem. In this connection, it is interesting to observe that budgetary procedures are usually introduced by companies because of poor operating results or because of financial strain, when it is unnecessary

to convince executives of the importance of cost and operating control.

But even more important for our particular problem is the need to educate the foremen and other operating men. They must be told what the company is trying to accomplish, how this is to be done and just what part they play in the whole plan. It will be desirable to have the production manager himself do the explaining to his own subordinates, because this will give the budget a prestige that it would lack if it were presented to the operating men by "just another accountant." This educational job is one of the most vital to the success of the budget, and it is in this area that not only most budgets but most accounting systems fail. Foremen must know what is going on and they must have a share in the setting of all budget estimates for which they are to be held responsible.

Setting up Spending or Control Areas—It is one of the axioms of budgeting that control of spending and responsibility for spending go together. A spending or control area must not be any larger than the area over which an individual has authority to incur expenditures. This requires departmentalization and sub-departmentalization to a much greater degree than is necessary for product costing alone. For example, in a textile mill, the usual functional classification such as picking, carding, spooling, etc., used for product costing is wholly inadequate for control purposes. The emphasis for our purposes must be by authority to spend, and we must always keep this idea before us, for one of the common errors that have been made in past years has been the attempt to use also for control purposes the lines set up for cost accounting. This means that the expenses of service departments will be controlled in the service departments themselves. The allocations necessary for product costing must be avoided when the object is control.

Determination of a Measuring Stick of Productive Capacity—This aspect of budgeting procedure involves a number of problems which will not be discussed at all in this short article. The whole difficulty centres in the fact that different kinds of expenses react differently as the volume of production increases or decreases, and it is only by studying these cost characteristics that we can make an intelligent estimate as to what expenses should be and

likely will be under a given set of conditions. To do this we must find a least common denominator or "limiting factor" in relation to which expenditures are made or costs incurred. To be suitable for our purposes such a factor must be easy to understand, readily obtainable and common to all departments of the business in the sense that they may be consolidated into figures for the company as a whole.

The number of units produced will be of use only in rare cases where only one product, or a number of very similar products, are produced. Direct labour hours or direct labour cost will be suitable in some cases, machine hours in others. One large company which has a varied output uses direct labour dollars because of its simplicity and because it found that this was almost a constant function of its billings. This measure has proven successful because in this particular company the relative proportion of the different products going through any one department remained fairly constant, and because the methods of manufacturing similar products were substantially the same with respect to the relation between the use of labour and the use of machinery. Another company uses labour hours in some departments, machine hours in some departments, man hours in others, and even a combination of these in others. The term 'productive hour' was applied to each of these. The principal point to keep in mind, however, is that there should be a causal connection between the measure chosen for a department and the expenditures of that department. And although simplicity is very essential, it should not be overdone to the point of distorting the facts.

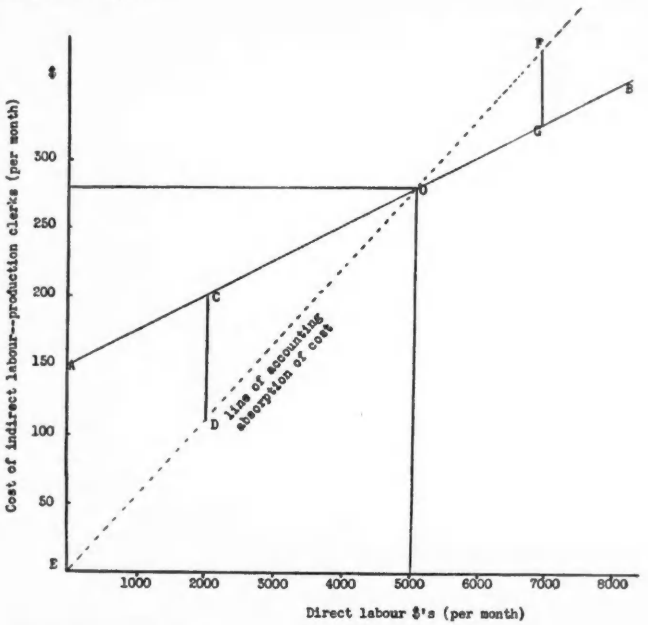
The problem of departmentalization arises here also, because aside from the question of the responsibility of department managers for the expenses of their departments, a departmentalization may be necessary in order to get a proper common denominator against which one can measure costs. It is quite possible that in any given spending area there might be a number of sub-departments, each with different cost characteristics. For example, foreman A might be in full charge of department A in which both machine-work and hand-work is performed. If the relative proportions of hand and machine-work do not remain fairly constant it would be necessary to make a sub-departmentalization. Of course if the 'mix' of products going through the department did not vary much from time to time, no

distortion would result by using one common denominator for the whole department.

Studying the Behaviour of Costs—Practical considerations make it impossible to study costs at every possible level of output. The usual and only sensible method is to estimate expenses at a given number of output levels, and interpolate to get the expenses at intermediate levels. In practice, each major class of expense will be studied carefully and a figure computed for each such expense at, say, ten different levels of production. These studies should be made very carefully for they are to be the basis of far-reaching policies in the future. Results of operations in past years may be used but they should always be tempered by the judgment of the operating men as to the future. In so far as it is possible, costs at at least three or four points within the normal range of operations (i.e., say, between 25% and 80% of capacity) should be studied in great detail. The results of these studies can then be plotted on graphs, along with other data gathered from past operating records. The appropriate measure of output is usually plotted on the horizontal axis and the dollar amount of the expense on the vertical axis. A straight line can then be fitted to the data. A straight line is mentioned because the experience of many companies leads to the conclusion that, at least within the normal range of activity, the amount of most manufacturing expenses tends to vary at a uniform rate with the rise and fall of operations. (As a rule, the larger the department, the more accurate will be the straight-line correlation.) And it is this characteristic of costs which makes it practicable to estimate costs at intermediate points by straight line interpolation between two measured points. This makes the budget much simpler than it would be if a curvilinear correlation were used, and most of the disadvantages of such a procedure can be overcome by a broad interpretation of reported variances from budget standards. One further word of explanation is necessary here. Although straight-line correlation will be found to give good results within the normal range of operations, it will be of very doubtful value when business is very slack or when facilities are taxed to the limit. Under such circumstances, judgment becomes a much more important factor in the administration of the budget.

At this point it might be of interest to discuss briefly the

relation between budget costs and product costs. And in order to do so, let us suppose that we have studied costs carefully in department X; that we have found that the indirect labour cost for production clerks is a direct function of the direct labour dollars; and that we have plotted our computed costs for production clerks against the corresponding direct labour dollar cost. We have chosen the line AOB as the line of best fit. Finally, we have determined that a direct labour load of $5,000 a month represents a normal or average which can be expected over the next number of years.



The line AOB shows the expected or normal cost for production clerks in department X at the different output levels and is used as a basis for planning and controlling costs. In other words, within the normal operating range, the budgeted cost for this item would be $150 plus 0.025 times the direct labour load for the output of the particular period in question. It should be noted that the extension of the line to the place where it cuts the vertical axis is

purely for the purpose of arriving at the fixed component of this variable cost item. Only within the normal operating range does it give an accurate picture of what this cost should be under controlled operating conditions.

The line EOF, on the other hand is the line of accounting absorption of costs. That is, orders going through department X are charged with indirect labour—production clerks at the rate of $5\frac{1}{2}\%$ $\left(\frac{275}{5000} \times 100\right)$ of the direct labour cost attributed to the orders as they go through this department. (Of course it is customary to combine a number of the indirect costs, and arrive at one or more composite rates to be used in applying burden costs to particular orders.) The vertical distances CD and EG indicate the expected under or over absorption of this item of burden at the given levels of activity. It is emphasized again that this line EOF is practically useless in cost control work.

In concluding this section of the paper, the fact should be stressed that foremen, supervisors and superintendents and all operating men who are to use the budget, should play the major part in making the cost studies. If they are not thoroughly conversant with the theory behind the budget, and if they are not made to feel that they are important cogs in this part of the wheel of company management, the success of the budget will be very problematical indeed.

Adapting the Accounting Procedures to the Budget— After we have made the above steps, we have to adapt the accounting organization so that in future it will provide all the necessary information at the right time. Care should be taken to see that there is no duplication of work. Much of the information gathered for financial accounting purposes can be used for control purposes also, and vice versa. The introduction of the budget will however, necessitate a much more detailed classification of expenses than will usually be found in the typical company. For instance, we must know not only the figure for indirect labour for the period but we must know also the figure for each control or spending area, and we must know this in terms of its component elements, such as clerical, timekeeping, cleaning, etc. When a foreman receives a report on his weekly expenditures he must know all the elements which go to make up the total. A single figure for indirect labour would

be almost meaningless to him and would provide him with only a very meagre control tool.

When deciding upon a proper accounting period, a distinction must be drawn between the fixed or annual budget, and the variable control budget. In the former case, a monthly, seasonal, or yearly budget will usually be prepared, but when the problem is control of detailed departmental expenses, it is essential that the period should be short enough so that the operating men will not have forgotten the conditions in their departments by the time the reports come out, and also the period should be short enough so that corrective action can be taken where necessary before it is too late. It is typical of many companies to use a weekly report for the detailed expenses of the foremen and a monthly report for the control of plant expenditures as a whole.

Form and Presentation—Undoubtedly, the most important consideration here is simplicity. Each report or chart must be prepared to meet the needs of the person or persons who are going to use it. They must not be cluttered up with details that are of no concern to the expected reader, and expenses over which a given operating man has no control should never appear on his budget report. Reports for executives will be consolidations of plant or department reports, which in turn will be consolidations of superintendents' and foremen's reports.

There is also a lot of room for the budget director to exercise his ingenuity in the arrangement and form of the budget material. He should recognize or attempt to discover the preferences and aptitudes of the different individuals who will be using the reports. Some men like charts and graphs, others prefer the actual figures; if we remember that a budget can be no better than those who operate and use it, we will realize how important this aspect of the problem is.

Analysis of Variances—It is not the hope of management that all variances of actual from budget can be eliminated. Practical limitations of necessity mean that the budget figures are not truly representative of what costs should be; variances are expected. The problem of budgetary control is to point out these variances and the causes of them, with the idea of keeping them at a minimum, or explaining them in terms of operating conditions not al-

lowed for in the budget, such as an increased proportion of special order work, a decrease in the size of the average order, etc.[1] Minor variances of course will have no significance. Also, variances in certain types of expenses will be of significance only on a cumulative basis. For instance, in a machine shop, grinding wheels and other semi-variable tools will be used up in proportion to the volume of production, but they will be purchased in irregular lots. The budget figures should show the expense incurred through the consumption of the tools, and there are bound to be short run variations between this and the actual figures showing the purchase or requisitioning of the tools. Such variances will be significant only over a period of time, that time being a function of the life of the particular type of tool involved, and the rate of production. Of course, there are certain costs of an extraordinary nature such as the cost of a strike, or damages to plant by fire or otherwise, which do not lend themselves to budgeting. They are nevertheless very real and when action is contemplated on such things as fire protection, employee welfare projects, some attention should obviously be given to them.

In setting up a budget it is also important to determine in advance how you will deal with specific variances which might be expected to occur within a given spending area. The budget must be made flexible, and much of this flexibility must be provided by the administration of the budget. For instance, the budget does not allow for costs which are due to changes in the rate of operation, (both as to direction and suddenness of the change), changes in labour turnover, change in the number of styles being produced, etc. Great care is necessary in the interpretation of the budget variances, and the more the management knows about the possible factors which might affect costs,

[1]It is interesting to observe that at least one company draws up its budgets for direct labour and materials on the assumption that perfect performance will be achieved. But it also draws up a budget or bogey of expected variances from these predetermined standards. That is, it recognizes the fact that spoilage and sub-standard use of labour and equipment are inevitable, if only because of the human elements involved; it considers such costs legitimate additions to the cost of production. However, by actually budgeting for each of the particular "losses," such as losses due to defective material or workmanship, defective drafting or engineering, etc., it endeavours to control such costs. Such a budget will of course be prepared by areas of responsibility for the losses.

the better will it be able to explain and account for variances.

In concluding this aspect of the budget one warning is necessary. Unless budget estimates are continually revised, they will lose much of their significance because, as management gains experience in controlling costs, the cost characteristics themselves will almost certainly change.

Uses and Advantages of the Budget

Having gone into some detail as to the nature of the variable budget and its development, and having outlined briefly the principal guiding considerations in the establishment of such a budget, it remains to point out the uses and advantages that a company might expect to find in such a budget.

There are a number of important advantages to be derived from the use of budgets by the chief executive officers of a company, such as assisting in the coördination of sales, production and financial policies, but it is not intended to follow out this line of thought here because it is the fixed or annual budget which plays the major rôle in such considerations. The writer wishes to direct attention only to the particular advantages and uses of the variable budget as it applies to manufacturing expenses.

One of the principal advantages that may be gained through the introduction of such a budget system, comes through the investigation of costs and their behaviour at different levels of output.[2] An intelligent approach to cost

[2]It should be pointed out here that the volume of output is but one of a number of operating factors influencing cost. For example, as already indicated above in discussing cost variances, changes in the rate of output, size of the production order, and the number of styles being produced also have an effect on costs. At the present time, it is usually considered inadvisable to introduce these complications into the budget formally. Simplicity is especially desirable here since the budget procedure involves all operating men down to the foreman level. However, it will be interesting to watch the development of budgeting in this area of refinement. As we look back over the last five years, we can see a steady growth in the use of control devices which would have been thought foolish ten or fifteen years ago, when tolerances of control were much wider, competition not so keen and business organizations not nearly so large and complex as they are today. The Robinson-Patman Act which forces manufacturers in the United States to justify price discrimination where it exists, and other regulatory and supervisory activities of governments both here and in the United States will perhaps hasten the development of statistical refinements in the analysis and control of costs. Those interested in persuing this

reduction is impossible without actual knowledge of the causes underlying cost variations. An important advantage that results from the examination of the behaviour of costs, is the assistance it gives to the management in estimating future profits under different assumed conditions of operations, thus enabling it to arrive at a cost, price, volume relationship which will lead to the maximum net profit to the company over a period of years. Similarly, when appraising such problems as whether a certain large order should be accepted at a price which does not cover average costs, or whether to buy or make a certain part used in the assembly of the final product, or how much additional sales volume must be secured to make a sales promotion program successful, in all these cases a knowledge of the variable cost characteristics of the company is essential if a sound decision is to be reached.

This sort of a budget also trains shop men to think in terms of dollar costs. It teaches them to appreciate values, trains them in the functions of management, and fosters economy. It gives operating men an intelligent estimate of what their detailed expenses should be under the conditions expected during the coming period, and also gives them check-up information at sufficiently short intervals that corrective action can be taken before it is too late. It eliminates delayed reductions in costs in times of falling volume, and prevents unwarranted increases in times of rising volume. It enables executives and operating men to plan action in advance and it thus eliminates losses due to errors which are otherwise inevitable when decisions have to be made under the stress of actual operations.

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subject further, should read the following interesting article by Professor Joel Dean: "Statistical Determination of Costs with Special Reference to Marginal Costs," *Studies in Business Administration*, Volume VII, No. 1, University of Chicago Press, 1936.

ACCOUNTANTS AND THE LAW OF NEGLIGENCE

By W. Summerfield and F. B. Reynolds
London, England

Editor's Note—This series of articles on a subject of wide interest to accountants, written by W. Summerfield, M.A., B.C.L., LL.B., and F. B. Reynolds, A.C.I.B.—authorities in the fields of law and insurance respectively—and appearing in *The Accountant* (London), is published with the kind permission of the Editor of that magazine.

(Continued from March 1941 issue; this month's instalment is the conclusion of the series which started in the February 1940 issue)

Shareholders' Negligence

Two important aspects of the subject of damages and their proper assessment have been exhaustively examined (by an odd coincidence) in another case in the Canadian Courts. With one we dealt under the heading "Damages." We have now to consider the case of *Trustee of the Property of Blue Band Navigation Co., Ltd. (a bankrupt)* v. *Price, Waterhouse & Co. (The Accountant,* 16th June 1934, pp. 853-870).

The company was incorporated under the British Columbia Companies Act, which followed the model of our own Companies Act; such a company was entitled to make loans to shareholders. One Whittall, who was a director and manager of the company, was also one of its largest shareholders, and he had obtained from the company substantial advances from time to time; on 30th September 1931, the company was adjudged a bankrupt and the plaintiff claimed from the defendants damages for negligence as auditors. Judgment was given (in July 1933) in favour of the plaintiff, in the sum of $25,000 with costs, by Mr. Justice Fisher, in the Supreme Court of British Columbia; in the Court of Appeal of British Columbia, however, the defendants successfully appealed, the five Judges there being unanimously in their favour.

Failure of Guarantor to Pay—In the balance sheets as at 30th June of 1929, 1930 and 1931, signed by the defendants without qualification, there was an item of indebtedness against the Western Trading Syndicate, which was apparently (in effect) an *alias* of Whittall. That item first came into existence towards the close of the financial

year ending 30th June 1929, when a "transfer as per Mr. Whittall's instructions" was effected by crediting Mr. Whittall's account with the sum of $25,000 and debiting the account of the syndicate with the like sum. When the defendant's representative in charge of the audit sought information as to the syndicate and the value of its indebtedness as an asset of the company, Mr. Whittall informed him that the business of the syndicate, its constitution, membership, ventures and assets were all highly confidential matters which he was not prepared to disclose beyond the fact that it was speculating in the stock market; as to its indebtedness to the company, however, he, Mr. Whittall, would personally guarantee the account. Subsequently, the account of the syndicate underwent increase and decrease, and at the date of the bankruptcy of the company it was in debit to a total of $25,000. That sum was never recovered, for on the company going into bankruptcy it sued Whittall to judgment on his guarantee, but the judgment proved worthless, since Whittall proved to be without assets. That loss the company now sought by this action to recover from the auditors.

Principal Debtor's Status—Mr. Justice Fisher held that the auditors were liable to make good this loss. They had been negligent, in his view, in being content to place reliance wholly upon Whittall's guarantee, without knowledge of the syndicate and its activities; those activities comprised speculative enterprise, for which purpose loans by the company were not authorized either by the directors or by the shareholders; nor had the auditors ascertained whether, in fact, Whittall had authority to direct a transfer of indebtedness from himself to the syndicate. Although upon the evidence before him he could not find that Whittall could and would have discharged the indebtedness if he had been called upon so to do in 1929 or in 1930, nevertheless the company had, by reason of the conduct of its auditors, lost the opportunity of making such a demand and the possibility of recovering the sum in question, which sum was, accordingly, the measure of the damage which the company had sustained and become entitled to recover. The conduct of the auditors was impugned in that (a) they had failed to communicate to the shareholders such knowledge as they had acquired regarding the manipulations of the syndicate's account (whereby the amount standing to

its debit was at times increased and at times decreased by profits apparently earned and credited to or paid over to the company); and (b) the auditors had not disclosed to the shareholders, as their certificates purported to affirm, a true and correct view of the state of the company's affairs as exhibited in its balance sheets.

Shareholders' Knowledge—At the annual meeting held in December 1929, one shareholder had, indeed, asked for information about the syndicate; the question was put to, and answered by, Whittall; could the auditors in the circumstances claim that the shareholders were informed, even though the information did not come from them, that the indebtedness of the syndicate was guaranteed by Whittal, so as to pass to the shareholders the responsibility of accepting such a guarantee as being a protection to the company?

Avoidable Loss—Macdonald, C.J. (of Court of Appeal), said that when accepting Whittall's guarantee, the auditors knew him to be a man of substance, owning a large block of shares in the company on which the company held a lien for any sums which might be due to it from that shareholder. Although the auditors had not disclosed to the company the details of their discussion with Whittall leading up to his furnishing of a guarantee, its terms were set out by them in their report on their audit for the financial year 1929. The sum of $25,000, he proceeded, was taken by the trial Judge to have been the balance of the amounts advanced by the company to the syndicate and did not arise from any investments by the company in the syndicate or its ventures. The auditors had done no more, and no worse, than the shareholders themselves who had (a) assented, with knowledge, to the amount outstanding with the syndicate; and (b) had not called in the guarantee. Furthermore, the very fact that a guarantee had been required put the shareholders in the position of having been warned of the existence of a risk—since otherwise no guarantee would have been necessary. It was idle for them to complain of a loss which they themselves might have averted had they proceeded against Whittall when he was still "good for the money." The loss could not properly be said to have been caused by the auditors.

Auditor as Scapegoat—McPhillips, J.A. (concurring) pointed out that Whittall's holding in the company was

sufficiently large to give him practical control of the company, and that it was not until 1930—some 10 years after the defendants became the auditors—that the company fell upon lean times. It is not uncommon to find that when losses have been incurred a scapegoat is sought, and the auditor is usually at hand to be used as such. But the shareholders had all those years rarely troubled even to attend meetings in any numbers and had been content to leave affairs very much in the hands of the directors. Why should the auditors have been suspicious of the conduct of affairs by Whittall, and of his current account in particular, especially when the vice-president had assured them that the information vouchsafed to them regarding his account by the president (Whittall occupied that position for at any rate some portion of the relevant period) was not otherwise than reliable?

Client's Self-Help—Another point raised in this judgment was that the plaintiff had not proceeded against the syndicate before resorting to the guarantor; he had not shown that he could not have avoided the loss if he had done that; hence, the loss could not be said to flow from anything which the auditors had done or omitted to do. He could fasten the loss on to the auditors only if he could show that he had exhausted available remedies against the syndicate and that they had proved worthless.

Directors' Duty—It was no part of the auditors' duty to criticize the use of the company's moneys, whether speculative or otherwise. It was the function of the directors to determine how the company should transact its business and whether the parties with whom the company was conducting accounts were substantial or unreliable. In fact, "if anything it was something in excess of their legal duty" for the auditors to have exacted the guarantee. Only when auditors knew that money was being entrusted to persons "notoriously unworthy of credit" did they become saddled with a duty to comment in such a case as this. The auditors would appear, by the judgment in the Court below, to "have been placed in the position of insurers—a position absolutely untenable and incapable of being substantiated." He thought a useful analogy could be drawn between the circumstances revealed by this case and those referred to by Pollock, M.R., in *Re City Equitable Fire Insurance Co., Ltd.* ([1925] Ch. 407, at pp. 505, 506), where he said "it was

not a matter of very great concern, if all had gone well, whether this money was advanced to the ranch (an investment in which the City Equitable Co. was concerned) by Ellis & Co., or a partner in Ellis & Co., or one of the persons concerned in it. The sum of £11,000 was comparatively not a very large one, and whether it was debited to one account or another was a matter of little moment . . . at that time I think there is no doubt from the evidence that Ellis & Co. could have drawn, or certainly were supposed to be able to draw, a cheque at any time for £11,000, and that £11,000 is found included in the sums at call or short notice." And Pollock, M.R., said, further, at p. 514: "I am not content to say that simply because a certificate was accepted otherwise than from a bank therefore there was necessarily so grave a dereliction of duty as to make the auditors responsible . . . It is for the auditor to use his discretion and his judgment, and his discrimination as to whom he shall trust." Indeed, "that is the right way to put a greater responsibility on the auditors."

"Collectability" of Debts—Finally, we may refer to some of the observations of M. A. Macdonald, J.A. (of Court of Appeal). The auditors, in his view, were no more under a duty to probe into the affairs of the syndicate in order to form a reasoned opinion of the "collectability" of their account than they would be to examine the books of other debtors—which in fact they would, as a rule, not be permitted to do even if they were so minded. They were entitled to consider as a good asset an indebtedness which was "perfected by what, in view of all the known facts, might reasonably be regarded as a good guarantee." Nor was there any concealment of the dealings with the syndicate, for it duly appeared on the balance sheet as a debtor just as "advances to shareholders" were also shown. "It may be said that Whittall's refusal to disclose was at least unusual, if not indeed suspicious, and comment thereon might well have been made in an appended note. That, however, is simply criticism, and more is required as a basis for a finding of negligence."

Loose Bookkeeping—As to the transfer from Whittall's account to that of the syndicate, it had been explained to the auditors that an error in the bookkeeping was corrected by the transfer. "Careless bookkeeping methods by men looked upon as reputable would not necessarily

suggest fraud." For "auditors in their work must often encounter loose bookkeeping methods." Explanations should be called for; that had been done in this case.

Auditors Not Censors—The learned Judge thought that it might have been said of Whittall in 1929, as was said by Lopes, L.J. (at p. 286), in *Re Kingston Cotton Mills Co.* (No. 2) ([1896] 2 Ch. 279): "In this case the auditors relied on the manager . . . He was trusted by everyone who knew him . . . They had no suspicion that he was not to be trusted to give accurate information . . . and they accordingly trusted him."

"I have no doubt," he concluded, "that the conduct of Whittall was not free from blame and the management of the company loose and unsatisfactory. Auditors, however, are not censors and shareholders with knowledge and the obligation to act cannot unload their neglect" upon the auditors. In short, the loss sustained flowed from the negligence of the shareholders and not from negligence (if any) on the part of the auditors.

Arbitration and Valuation

Accountants are frequently invited to sit as arbitrators (or umpires). In that capacity they do not render themselves liable to claims for negligence. But there are many functions closely akin to, and resembling, those of arbitrators which do involve such a risk. It is most important, therefore, on being invited to adjudicate in any sort of way to have it made quite clear in which of several possible capacities one is expected to act.

Difference or Dispute—The essence of arbitration is a *quasi*-judicial determination of a difference or dispute, i.e., a trial of issues which have arisen between parties who prefer not to resort to litigation over them in the courts. They choose, accordingly, a third party in whom both have confidence, and they expect and require him to settle the matter in much the same way that a judge would in a court of law, but with a privacy and some informality which would not be available in the ordinary way in a court of law.

Doubt without Difference—But there are many cases where no difference or dispute has arisen between parties who yet require the services of a third party to bring an unbiased mind to bear upon problems which may have

arisen between them. Thus, A may claim against B that he has been wrongfully dismissed from his employment, and A and B may jointly agree to refer the whole matter to C as arbitrator. C will then be under a duty to decide whether in fact (and in law) A has been wrongfully dismissed and if so, what damages B ought to pay. If C is negligent no action will lie against him, for A and B chose him, and it was for them to select a reliable person.

But suppose A and B are upon perfectly amicable terms, and there is admittedly due from B to A certain commissions. Neither A nor B has formulated a definite view as to the amount due; perhaps, neither feels competent to arrive at the figure. They may jointly desire C to make the calculation or assessment, and C's function will probably not be that of an arbitrator.

In the former example if C arrives at a wrong figure through negligence, no action will lie against him, whilst in the latter it well may; the distinction may be gathered from the following cases.

In *Boynton* v. *Richardson's* ([1924] W.N. 262) the defendants, a firm of surveyors and valuers, had been retained by the plaintiff (as vendor) and the purchaser of the plaintiff's timber jointly to value the timber. Both vendor and purchaser had agreed to abide by the defendants' valuation. The plaintiff claimed damages from the defendants, alleging that they had, by their negligence arrived at a figure below the true market value, so that he had been induced to sell his timber at a price lower than that to which he should have consented. By their defence the defendants contended that no action for negligence lay against them, since they had acted as *quasi*-arbitrators. For the plaintiffs it was contended that the defendants had been appointed as "mere appraisers and valuers," and that they were not "intended to exercise their judgment upon matters in which the interests of the vendor and purchaser might conflict." Mr. Justice Greer, in the course of his judgment, said that such a valuation involved impartial consideration by the valuers as to measurements, current prices and the like. The rule that no action for negligence lay in such circumstances extended not only to arbitrators but also to *quasi*-arbitrators; for all such persons ought to be able to exercise their judgment "free from the embarrassment of a possible action for negligence."

Fine Distinctions—The distinction, then, is sometimes a very fine one. The person to whom the problem is referred is not an arbitrator (or *quasi*-arbitrator), when what is required of him is not a judicial (or *quasi*-judicial) investigation but his personal opinion. To form that opinion he brings expert knowledge and skill to bear. But, as Chief Justice Cockburn observed in *Re Hopper* ([1867] L.R., 2 Q.B. 367), the proposition, that where "value or compensation only" is involved the matter is not to be regarded as an arbitration, must depend upon the particular circumstances of each particular case. In that case the terms of the lease of a farm provided that the lessee might be required to surrender the property if it should be sold during the currency of his tenancy, subject to his being paid compensation. The compensation payable was to be determined by two valuers, one to be nominated by the landlord and one by the tenant. The "valuation" which had in fact taken place, said the learned Chief Justice, exhibited all the essential features of a judicial inquiry, for counsel attended before the valuers on behalf of the respective parties, and a number of experts were heard who tendered conflicting evidence on either side. The parties themselves intended that evidence should be considered. It was not the sort of case where "a reference is made to a person to state what is the value of a stack of hay or the plant of a brewery, and he has only to use his eyes, so to speak, to ascertain the value."

Valuation—In *Collins* v. *Collins* ([1858] 26 Beav. 306) a brewery and plant, part of the assets of a testator, were to be sold, and his executrix entered into a written contract for sale to a firm of that property at a valuation. It was agreed between vendor and purchaser that the purchase money should be determined by a person therein named for the vendor and by another named person for the purchaser. The Master of the Rolls (Sir John Romilly) said that fixing the price of a property may constitute an arbitration. But in this case it could not be said to constitute an arbitration.

"If nothing has been said respecting the price by the vendor and purchaser between themselves, it can hardly be said that there is any difference between them . . . A valuation prevents differences, and does not settle any which have arisen." Here was a contract with an "auxiliary

arrangement" respecting price; in such a case "in order to save discussion and to prevent differences which might arise between the parties" it is agreed that the price is to be fixed by two persons.

It is precisely in order to save discussion and to prevent differences arising that parties frequently invoke the aid of an accountant who can more easily and more confidently analyze complex accounts and formulate deductions therefrom. In such cases the accountant becomes liable for negligence if he does not competently analyze, or if he formulates improper deductions. He is retained to discharge the functions of an accountant and not of an arbitrator.

Borderline Cases—It is all the more important to discern clearly the distinction in law, since parties frequently mistakenly interchange the terms "valuation" and "arbitration." Moreover, as the Master of the Rolls (Lord Esher) pointed out in *Re Capis—Wilson and Greene* ([1886] 18 Q.B.D. 7), cases arise of an intermediate kind where parties appoint a person to settle disputes which have actually arisen, but without intending that he shall hear evidence and arguments, and in such cases it may be difficult to decide whether he was intended to be an arbitrator or a valuer.

This much, however, is clear that "you cannot make a valuer an arbitrator by calling him so, or *vice versa*"—*per* Mr. Justice Neville in *Taylor* v. *Yielding* ([1912] 56 Sol. Jo. 253).

Lord Chief Justice Coleridge in *Stevenson* v. *Watson* ([1879] 4 C.P.D. 148) drew a distinction between "ministerial" duties and the discharge of functions calling for "the exercise of professional judgment, opinion and skill." The former, involving no more than the making of calculations, opened the way to an action for negligence—if the calculations turned out to have been incompetently made, whilst the latter did not. In the latter functions would be included the duty, for example, of deciding whether particular portions of work in respect of which one party was claiming for remuneration from the other were properly executed in accordance with the terms of the contract made between them; that is to say, the referee would require to exercise professional skill and judgment, and to aid his own judgment he might require to assess evidence before he could

embark upon his calculations. An accountant, like an architect, is often in the position of having contractual relations with one of the two parties between whom he is asked to adjudicate, and it is this relationship which introduces the complications which make it often difficult to decide whether his adjudication constitutes a mere valuation and assessment or an arbitration.

In *Pappa* v. *Rose* ([1872] L.R., 7 C.P. 525) a broker had been employed to effect a sale of goods, and it was agreed between the seller and the buyer that the opinion of the broker should determine whether the goods tendered were of the quality stipulated for by the contract. It was held that the broker was thus placed in the position of "a sort of arbitrator," and so not liable in negligence. All that was required of him was that he should discharge his duty honestly and to the best of his judgment. An accountant is frequently placed in a similar position, when he is required to furnish certificates relating to property in respect of which he has introduced a seller and a buyer.

In *Chambers* v. *Goldthorpe* ([1901] 1 Q.B. 624) an architect was employed by a building owner to supervise the erection of houses by a contractor. The building contract provided that payments on account were to be made during the progress of the work upon certificates furnished by the architect. It was held that in furnishing such certificates the architect acted as arbitrator, and was not liable to an action for negligence in respect of, for example, measuring up the work or calculating sums due.

Valuing a Business—*Turner* v. *Goulden* ([1873] L.R., 9 C.P. 57) was a case where it was held that an action for negligence would lie, and that the defendant was not acting as an arbitrator in any sense; he had been engaged by the plaintiff to act as his valuer to determine what sum the plaintiff should pay as purchase price of the business, including its goodwill.

The plaintiff had agreed to buy the business at a sum representing "one year's net profits," the stock-in-trade and fixtures to be taken over at a valuation. The valuation was to be arrived at by the estimate of two valuers, one to be appointed by the vendor and the other by the purchaser. In the event of a difference between the two valuers an umpire was to decide. The plaintiff's complaint was that

the valuers had, in error, taken the wrong periods from which they deduced their "average."

Insurance

Reference has been made (under "Negligence") to the possibilities open to the accountant of protecting himself against claims for negligence by means of insurance. An indication has been given that the scope of cover available is wide, but not unlimited. We propose to consider now, with particularity, the nature of such insurance policies.

Indemnity—The Accuntants' Indemnity Policy, as it is termed, may be effected either (a) with one of the insurance companies, or (b) at Lloyd's. The accountant who desires to effect insurance of category (a) may do so either by negotiating with the company direct or through one of its agents, but if he decides upon (b) a Lloyd's policy, the business must be transacted through Lloyd's brokers.

As with other kinds of insurance, proposal forms and forms of policy admit of numerous variations in detail, but for the purpose of examining the legal aspects of this class of insurance it will be convenient to consider its main features by reference to typical forms in use by Lloyd's which, in essentials, may be taken as typical of most.

Proposal—A printed form of proposal is required to be filled up and signed by the proposed assured, so as to provide particulars of the proposed insurance and answers to a number of questions prepared by the insurers. It is vitally important that the assured provides truthful answers, and the proposal form usually concludes with a form of declaration, to be signed by the assured, so as to certify the truthfulness of the information given by him. Inaccuracy in the proposal form renders the policy voidable, and the truthfulness of its contents is a condition precedent to the validity of the policy.

Approved Form—The form approved by Lloyd's (Underwriters' Fire and Non-Marine Association) is as follows:*

LLOYD'S ACCOUNTANTS' INDEMNITY POLICY
PROPOSAL FORM

Questions	*Answers*
1. Full names of all Partners and address of firm	

*Reproduced in *The Accountant* by permission of the Committee.

2. When established
3. Length of public practice of Partners
4. State qualifications (i.e. whether Members of Chartered Institute, Incorporated Society etc.)
5. Do you undertake to act as Liquidators, Receivers or Trustees in Bankruptcy?
6. Total number of Partners and staff
   (a) Partners
   (b) Staff other than typists and office boys
   (c) Typists and office boys
7. Have any claims been made against your Firm in the past? If so, give full particulars
8. Have any claims ever been made against any of your present Partners either individually or otherwise? If so, give full particulars
9. Has any application for Insurance made by you or your predecessors in business ever been declined? If so, state reason
10. Amount of Indemnity required.

I/We hereby declare that the above statements and particulars are true, that I/we have not suppressed or misstated any material facts, that at the present time I/we have no reason to anticipate any claim being brought against me/us for any neglect, omission or error on the part of any member or employee of this Firm or their predecessors in business and agree that this declaration shall be the basis of the contract between me/us and the Underwriters.

Signature of Proposer.............................

Date...............................

Signing this form does not bind the Proposer to complete the Insurance.

Noteworthy Points—The following are the main points to be noted in connection with the above series of questions, and their significance will be more fully considered when we discuss the form and terms of the policy itself.

(1) The full names of all partners must be given, since provision must be made to meet the cases where claims are launched against a partner who has had conduct of a particular matter, e.g. as a liquidator (*cf.* Questions 5 and 8).

(2) The date when the practice began must be stated, i.e. even though it may previously have been carried on under a different style or title. (*cf.* Question 7).

(3) It follows as a corollary from 2 *(supra)* that the information would be incomplete if the length of practice of the existing partners were not stated. (*cf.* Question 8).

(4) A policy will not normally be issued unless at least one of the principals of the firm is a member of one of the recognized professional bodies which impose an examination qualification upon their members.

(6) Not only must the total number of partners (or principals) be stated but also the numbers comprising the various categories of staff. Both the premium payable and the indemnity available are determined, as a general rule, having regard to these totals, although, of course, it is recognized that there may be members of the staff whose functions do not directly comprise or include responsible work which is likely to give rise to claims; effect is given to this recognized factor by calculating, broadly, in units of three persons, i.e. to allow for principals with subordinates. A "nice" calculation in advance is not always possible as to which members of the staff are likely to do responsible work, or how much, in the period to be covered by the policy. Thus, a typist may or may not be allowed to exercise initiative, and even an office boy may make a mistake leading to a claim. The numbers employed afford guidance to the insurers in assessing the extent of the risk which they are asked to undertake. The numbers are taken as at the commencement of the insurance period and as at the date of renewal, no adjustment being made during the period in respect of premium and indemnity, whether by way of increase or decrease. Claims in respect of the conduct of persons appointed to the staff after the commencement of the period are covered, and even of such as were employed prior thereto; thus a very ample cover is available.

(7) and (8) The insurers do not require to know details of all or any grievances which have been presented to the proposed assured which were of a petty character or without real foundation; but if a payment has been made to settle a complaint with the object of avoiding a claim being made that is a relevant fact which must be disclosed. Particu-

lars of claims must include an indication of the causes which gave rise to them, the year in which they were made, and the cost of disposing of them.

(9) Particulars are asked of "any application for insurance," and not merely for "indemnity insurance," the reason being that if the proposer has been declined for fidelity guarantee, for example, that would be a relevant factor for the insurers to consider. All material facts must be disclosed, that is to say, all such as would influence the mind of a prudent insurer in accepting the risk or in assessing and fixing the premium. Failure by the proposed assured to disclose is not exercised merely because a question on a relevant factor is not specifically asked by the insurer.

(10) The amount of indemnity is usually fixed automatically, although variations can be arranged; normally, the minimum is fixed at £1,000.

Declaration—The first two sentences in the form of declaration summarize the duties with regard to stating the truth, and it should be noted that *suppressio veri expressio falsi*—suppression of the truth is equivalent to a false statement; the legal maxim applies with special force to insurance law.

"No reason to anticipate any claim being brought." This portion is extremely important; the proposed assured must disclose anything that has transpired which (a) could give rise to a claim if a discontented party were minded to formulate and pursue one, or which (b) may give rise to a claim, although, in fact, the accountant does not expect that there will be a claim. For example, (a), an accountant may realize that he has been guilty of some neglect, omission or error, although the client has not realized the fact—as yet; or (b) a client has complained to him that in his, the client's view there has been negligence on the accountant's part; the accountant may think that the client is so well disposed towards him (or for some other reason) that he does not expect him to launch a claim. In neither case would the accountant be justified in not disclosing his difficulty to the insurer.

Renewal—When a policy falls due for renewal the assured is deemed to re-affirm the declaration and the truth of the answers supplied on the proposal form. Hence, it is his duty to disclose "anticipated" claims before the expiration

of the existing policy period if he desires the protection of his existing insurance, and also because it is essential information which he must give to the insurer to avoid the renewed policy being rendered voidable.

DUTIES AND RESPONSIBILITIES OF NEW MEMBERS*

By Henry G. Norman, Chartered Accountant, Montreal

As President of your Society, a two-fold duty to you as new members of the Society now devolves upon me, one of which I have extreme pleasure in carrying out, and the other, which is the giving of advice, is one which I approach with some temerity.

It is indeed with considerable pleasure, as well as pride, that I welcome you as new members of our Society, and I congratulate you heartily upon having successfully met the examination requirements. A Society such as ours constantly needs infusion of new blood and additions to its membership in order that it may carry on its responsibilities to the public at large. So I welcome you not only as individuals whom we are glad to have associated with us in our practice but also as an addition to our ranks, which is so necessary for the successful functioning of the Society.

As I have mentioned, it is with some temerity that I now propose to offer some advice to you who have successfully passed your examinations and are tonight admitted as members of this body. Advice is something easily given, but if accepted and followed the responsibility is greater on the giver than it is on the receiver. I will, however, try to advise you of some of the responsibilities which you as members of our profession have tonight assumed, and trust that you will accept these suggestions in the manner in which they are given; namely, as a guide to you in the carrying on of your work so that it will not only be a credit to yourselves but also a credit to the profession of the chartered accountant in Canada.

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*An address by the President of the Society of Chartered Accountants of the Province of Quebec at the annual dinner in the Mount Royal Hotel, Montreal, 10th March 1941. The successful candidates in the December 1940 examinations were formally admitted as members to the Society at this time.

The passing of your examinations and your entrance to the Society are a milestone in your career of which you can all be justly proud, but this should also be looked upon as a stepping-stone which leads to many added responsibilities —responsibilities to the public as well as responsibilities to your fellow-practitioners. These two responsibilities are so interlocked that you cannot fulfil the one without fulfilling the other. There is also a further responsibility to the profession; considerable work must ever be done from an educational viewpoint, and voluntary services rendered in connection with the advancement of the profession. In assuming your share of these responsibilities, you will find that you will be deriving considerable advantage yourselves, not only in the satisfaction of being of help to the profession as a whole, but also from the information to be gained through studies undertaken in connection with these matters.

Some of you undoubtedly may have a feeling that having passed your examinations you are now finished with your studies. You will find, however, that if your work is to measure up to the standard expected of you, your studies have only just started. Much has been written on accounting theory and accounting procedure as a result of the experience and thought of many leaders of the profession. This is a source of information which all of you should be studying from time to time so that when, as the result of changing conditions in our economic structures, resultant changes in accounting procedure arise, you can be prepared to give serious thought to the problems to be solved. The conclusions to which you come should be based on a study of the history of the past as well as the requirements to fulfil the apparent needs of the time.

Our profession is being called upon today to a far greater extent than ever before to deal with matters requiring an impersonal viewpoint and a presentation of facts unbiased and untinged with prejudice. It is essential that we retain our position as presenters of facts and not assume a position of advocates. In an address given by the Commissioner of Income Tax to the Institute of Chartered Accountants of Ontario at their recent mid-winter dinner he referred to his understanding that the accounts presented by chartered accountants to the Commissioners of Internal Revenue of Great Britain were in the majority of cases accepted with-

out the necessity of an inspection of the taxpayers' accounts by representatives of the Government. He expressed the hope and the belief that a similar position would be attained in Canada. The attainment of this position, however, is one which depends entirely upon the members of the profession and not on governmental regulations.

I would like to warn you not to assume to yourselves virtues that you do not possess. By this I mean that there is a tendency today for chartered accountants to be regarded as individuals able to find the correct solution to any problem which may arise. We must, therefore, avoid placing ourselves in a position of giving advice on matters upon which others should be, and undoubtedly are, far more qualified to speak than ourselves.

The greatest asset that you have today as a chartered accountant is a reputation for integrity, confidence and trustworthiness. Safeguard this reputation by every means possible. Your signature, which not only affirms your own opinions but also indirectly affects the profession as a whole, must only be appended to statements and reports which are free from ambiguity, and which are made only after careful thought and consideration and a complete knowledge of the facts to which they refer.

Let us now turn to the conditions in which we find ourselves today. I wish to impress upon you the urgent necessity of being of every possible assistance in helping Canada and the Empire carry the present war effort to that successful conclusion which we all feel assured will result. Canada, together with the other members of the British Empire, is fighting for those things which we all believe to be dear to us, and we must not let our own personal ambitions stand in the way of doing those things which our country may call upon us to perform.

We cannot all be in the fighting services, although undoubtedly that is what we would all prefer, but we can be of real service to our country if we will make up our minds that in whatever sphere of activity we may be engaged, our work in that sphere will be carried on with more effort and zeal than may have been put into it in the past. You form part of this great war effort whether you are carrying on your business as a public practitioner, whether you are serving in one of the Government services, or are serving in

any of the Forces. The country is, and must be, one unit, and the successful result of this effort can only be achieved if every one of us exerts himself to the utmost in the sphere of activity in which his lot falls and does not relax until the victory over Nazism and Fascism is finally achieved.

Before proceeding with the presentation of prizes and diplomas, I would like to say to those students who were not successful in passing their examinations a word of encouragement. Things worth having, and certainly we feel the title of Chartered Accountant can be so classified, are not easily acquired. The additional study which you will have to undertake in order to sit your examinations at a later date should be looked upon as not only fitting you better to take those examinations but as fitting you better to assume your place with the other members of the profession on the successful passing of those examinations. My advice to you is put all energy possible into your studies in the coming period, and make up your minds that you are going to be successful and you will be successful. This success will add to your usefulness in the community as a whole.

CAN WE AFFORD TO LEND?

Editor's Note: **This article taken from a recent issue of *Business Week* (New York) has been sent in by one of our members for publication.**

One thing is certain. The proposal to get away from the dollar sign in extending aid to Great Britain is sound economics as well as good business. Apparently, a lesson has been learned from the last war.

The post-war world was unable to live up to the dollar obligations the war imposed. That was because a basic change had taken place in the economic relations of the United States with other countries. This change was recognized by some economists, but not by enough. It was recognized by some statesmen, but again by not enough. And even today, it is insufficiently understood or acknowledged.

The World War transformed the United States from a debtor nation to a creditor nation. Prior to 1914, the American investment stake in foreign countries was small; conversely the foreign stake in America was large, and, the United States paid interest and dividends to the rest of the world. But after 1914, this country was on the receiving end of interest and dividends. The following tabulation is by no means exact (data for early years are scant), but it serves to indicate that dramatic shift in American and foreign creditor-debtor relationships:

Year	Estimates of Foreign Investments in the United States	Estimates of American Investments Abroad	U.S. Creditor Position
1899	$3,300,000,000	$ 500,000,000	$2,800,000,000
1914	5,000,000,000	2,000,000,000	3,000,000,000
1927	3,700,000,000	12,500,000,000	8,800,000,000
1929	4,700,000,000	14,400,000,000	9,700,000,000
1939	4,800,000,000	10,800,000,000	6,000,000,000*

This transition from debtor to creditor nation makes it necessary to consider any advances of war materials or services to Great Britain in the class of outright gifts or at best as doubtful assets, if designated as loans. Certainly, no prudent dealer in securities would consider them negotiable I.O.U.'s. The reason for this is that the United States was not cut out to be a creditor nation; it was not

***The drop since 1929 is due to defaults on foreign bonds and to withdrawals of American cash funds from Europe.**

made to be a rentier and live on income from other countries. For, basically, the United States is a producer nation. With its vast natural resources, man-power, and productive machinery, this country today has not the economic constitution to receive interest and dividends from the rest of the world.

The nub of the matter is this: There are three, and only three, ways in which to pay off international obligations—(1) in goods; (2) in services; (3) through transfer of capital assets, such as gold, securities and, less frequently, real estate (such as colonial possessions). As a practical matter, no nation can continue meeting its obligations with capital assets for any length of time. Gold supplies, if there is a consistent outgo, are soon exhausted, securities are liquidated; and the same goes for colonial possessions. Therefore, at best, capital transfers can only be looked upon as temporary expedients. Eventually, a debtor nation must pay its interest and its dividends with goods and services; and that means, as a corollary, that the creditor nation must be willing to accept the debtor's goods and services in payment.

The paradox of the post-war epoch in international finance was that the United States persisted in its demands for payment of war debts and private debts, but just as persistently refused payment. Our economic policy — to protect American manufacturers and farmers — was designed to keep out foreign goods. The Hawley-Smoot tariff is the outstanding example of refusing to let the debtor in the door.

Now President Roosevelt has not said it in so many words but he has implied that when the time comes for Britain to pay back what it now borrows, it will be permitted to pay in goods. But Washington is apparently coming to recognize that, just as Britain has not the ability to pay cash now, so also this country probably will not have the ability to accept competitive goods after the war is over. Neither American manufacturers nor American farmers will be anxious to have British exports come into this market. So an "out" is suggested—that Britain be held accountable not for dollars, but for munitions. Which means (1) that repayments will not compete with American peacetime production, (2) that ultimately a token payment may be deemed satisfactory.

It is not to be forgotten that traditionally this country is an export nation. Since the 1870's the United States has exported more merchandise than it has imported. And because of its export balance of trade, payment of interest on foreign investments has never been a serious problem for this country. (Being a debtor nation is the economic complement of being a nation with an export balance of trade.)

But after the World War the United States was both a creditor nation and an export nation. And to aggravate the drain on the rest of the world, this country's export balance continued to increase instead of decrease. Consequently other nations sold securities over here and our creditor position further expanded. It was inevitable that the debtors would have to default.

Now we are about to embark on lending again. But neither the depression nor the war has changed this country's economic orientation. The United States is still an export nation; we still sell more goods abroad than we import. And after this war is over, our plant capacity will be geared to even greater exports. That is why it is good business as well as good economics for the government to treat these loans as in a special category—payable on a when, as, and if basis. For the fact remains that economically this country is constituted to be a bad creditor.

JUDGMENT RESPECTING THE INCOME WAR TAX ACT

The Emily L. Merritt Case

The assessment from which the taxpayer appealed in this instance was made in connection with the transaction by which The Premier Trust Company acquired the undertaking and assets of The Security Loan and Savings Company. By judgment rendered on 19th March 1941 the President of the Exchequer Court, Mr. Justice Maclean, allowed the appeal. The judgment discusses the matter from two standpoints, both of which have a definite interest.

The Transaction—The vendor company was to receive as consideration on the sale of its assets and goodwill a sum in money and certain fully paid shares in the capital stock

of the purchasing company. The purchaser also assumed the vendor's debts, liabilities and obligations including those under its debentures, its contractual and other obligations. The cash and fully paid shares were not payable and issuable to the vendor directly but to its shareholders. The agreement of sale, entered into in March 1937, obligated The Premier Trust Company as purchaser to allot and issue to each shareholder of the vendor company one and one-half fully paid shares of its capital stock, par value $100, for each share in the capital stock of the vendor company held by such shareholder. Alternatively, at the option of such shareholder, the purchaser was to pay $102 in cash and to issue one-half of one of its shares for each of the shares held by such shareholder. The vendor's shareholders were also to be paid in cash an amount equal to accrued dividend at the rate of 5% per annum for the period from 31st December 1936 to the date of the issuance to them of the shares of the purchaser. Fractions of shares were to be adjusted in cash. The appellant accepted the second option and received $26,690.75 in respect of her 259 shares together with 130 fully paid shares of the Premier Company.

Undistributed Income of Vendor—At the time of the sale the vendor had on hand undistributed income in the amount of approximately $212,000. No evidence was submitted to establish in what years and in what amounts the income was accumulated though the appellant represented that no part of it was accumulated in the years from 1935 to the time of the sale, and this was not disputed by the Minister. The appellant was assessed in the sum of $10,192.60 in addition to her other income, as being her share of the undistributed income referred to. This was stated to be pursuant to section 19(1) of the Act which provides that on the winding-up, discontinuance or reorganization of the business of any incorporated company, the distribution in any form of the property of the company, shall be deemed to be the payment of a dividend to the extent that the company has on hand undistributed income. Mr. Justice Maclean held that the transaction between the two companies resulted in the winding-up of the vendor company and accordingly the appellant was deemed to have received a dividend upon a consideration of section 19(1) alone.

Successful Argument—The appellant having failed on this point argued that nevertheless there was no liability as section 19(1) only made subject to tax undistributed income which was accumulated in 1935 and subsequent periods and that the undistributed income of the vendor was all accumulated prior to 1935. The present section 19(1) was introduced as section 11 of chapter 38 of the Statutes of 1936. Section 22 of the same amending Statute of 1936 provided that section 11 should be applicable to the income of the year 1935 and fiscal periods ending therein and of all subsequent periods. In construing this section Mr. Justice Maclean reviewed the history of predecessor sections to section 19(1). The first of the sections was enacted in 1924 and the wording was the same as at present. By another section the enactment was to be deemed to be applicable to the income for 1921 and subsequent periods. In 1930 the section was repealed and re-enacted in identical words except that there was added at the end of the section the words "earned in the taxation period 1930 and subsequent periods." These added words were repealed in 1934 but a provision of the 1930 amending Act which stated that that Act should be applicable to fiscal periods ending in 1930 and subsequent periods was not repealed. This history indicated that in some periods at least the total undistributed income was not taxed but only that part of it which was earned in a specified period and subsequent periods. Whatever the reason behind such enactments, the language was unequivocal and the statement was a plain matter of public policy in a public statute. According to His Lordship's conclusion, the combined effect of section 19(1), as enacted in 1936 and section 22 of the amending Act of that year, was that the undistributed income made taxable as a dividend was not intended to include income earned earlier than 1935 but undistributed and on hand. The appeal was allowed but subject to verification of the representation that no part of the undistributed income was accumulated at the material times.

FOREIGN EXCHANGE CONTROL BOARD

Ottawa, 1st March 1941

Settlement Between Resident Firms of Public Accountants and Their Non-Resident Offices of Correspondents

Austin H. Carr, Esq.,
Secretary-Treasurer,
The Dominion Association of Chartered Accountants.

Dear Mr. Carr,

As you are aware, the Foreign Exchange Control Order has been revised recently and certain new Regulations have been passed. These changes were included in the issue of The Canada Gazette dated 16th December 1940, copies of which you have distributed to the members of the Association.

The amendments will necessitate some changes in the method of settlement between resident firms of public accountants and their non-resident offices or correspondents, and these are set forth hereunder.

As stated in our letter, which was published on page 183 of the March 1940 issue of The Canadian Chartered Accountant, there was at that time no specific provision in the Foreign Exchange Control Order or in the Regulations with respect to the types of currency which must be received by resident public accountants for professional services rendered to non-residents. This position is now changed and Section 27 of the new Foreign Exchange Control Order requires that, in short, residents obtain United States dollars in respect of such services rendered to residents of any country (other than Canada or Newfoundland) outside the sterling area. Regulation 29 sets out certain circumstances under which Canadian dollars may be accepted in respect of such services.

The expression "services" is defined in Section 27(2) of the Order: payment for services includes both fees and disbursements.

You will note that Section 27 of the Order requires payment to be not less than the fair value of the services "in United States dollars." Where an account is computed and the result is expressed in terms of Canadian dollars, the equivalent amount in United States dollars should be considered as (using the present official rate of exchange) 90.91% of the account.

The Board does not wish that that part of Section 27 which provides for "payment within six months" should require members of your Association to discontinue rendering accounts annually in cases where this has been their practice in the past. General permission is accordingly granted for the rendering of annual accounts but it is, of course, in the interests of the country that sums receivable in United States funds should be obtained as soon as is reasonably possible.

May we assure you that the Board will welcome enquiries from your members in regard to their own affairs or to the affairs of their clients, and it is at all times anxious to assist them in any way possible in matters arising out of the duties of the Board.

Yours, truly,
(Signed) James E. Coyne
Secretary.

INCOME WAR TAX ACT OF CANADA

and

THE EXCESS PROFITS TAX ACT, 1940

Departmental Rulings

The following ruling respecting the administration of the *Income War Tax Act* has been issued recently by the Department of National Revenue, Income Tax Division:

Non-Resident Officers and Employees of Canadian Companies, Performing Some Part of Their Services in Canada

Section 2, paragraph (c) defines "employed in Canada" and section 9 (1) (c) provides that every person "who is employed in Canada during such year" shall pay a tax on his total income from all sources.

Reading these two sections together, it is apparent that any officer or servant regularly or continuously employed by a Canadian company to perform personal services, *any part of which is performed in Canada,* for salary, wages, fees, etc., is liable for Canadian Income Tax on his total income.

Section 6 (1) (m) provides for the disallowance as a deduction to a Canadian company of the excess over $14,000 paid by such company to a non-resident in respect of salary, bonus, directors' fee or other like remuneration, unless such non-resident pays tax on such excess.

You are hereby advised that non-residents of Canada who come within the definition of "employed in Canada" by performing any part of their personal services in Canada for salary, etc., are to be taxed on the amount received by them from the Canadian company up to $14,000. In respect of the excess above $14,000 paid to such non-residents, this to be disallowed as a deduction to the Canadian company in determining the latter's income, unless the non-resident officer or employee files an Income Tax Return and pays tax on such excess in addition to the $14,000 upon which he is to be assessed in any event.

Section 25 (2) provides for withholding 15 per cent of any salary, fees, commissions or other remuneration payable to any person residing outside of Canada in respect of services rendered by such person in Canada, such withholding to be made by the Canadian company making the payment.

You are advised that 15 per cent will have to be withheld on all salaries, etc., paid to non-resident officers or employees of Canadian companies who perform part of their services in Canada up to an amount of $14,000 but that the 15 per cent need not be withheld from the excess over $14,000 paid as salary, etc., to any such non-resident officer or employee.

This memorandum is applicable to assessments yet to be made in respect of incomes of 1939 and thereafter, except that the 15 per cent withholding tax applies only from 25th June 1940. *(Issued February 1941)*

The following ruling respecting the administration of the *Income War Tax Act* and *The Excess Profits Tax Act, 1940* has been issued by the Department of National Revenue, Income Tax Division:

Summary of Basis of Assessing Prospectors, Associations of Persons and Corporations Engaged in Prospecting, Exploration and Development in the Metalliferous Mining Industry.

A bona fide prospector who sells, transfers or assigns his rights to a mining prospect is not liable to income tax or excess profits tax on the consideration received, as such consideration constitutes capital.

For the purpose of the preceding paragraph, "bona fide prospector" includes a person who has personally carried out the whole or major part of the field work of prospecting and exploring for mineral, and includes any person, association of persons, or corporation which has contributed to the expenditure incurred in the work of prospecting, exploration and development of mining properties for the purpose of establishing a producing mine.

Where any person, association of persons, or corporation individually or collectively with others directly contributes work, money or other assets to assist in prospecting, exploration or development, and in such prospecting or exploration he or they acquire by staking, purchase or otherwise, mining claims, shares of stock or any other assets which represent the result of prospecting, exploration or development effort conducted by him or them, and sell, transfer or dispose of such claims, shares or assets, then the proceeds of the sale, transfer or disposal of such claims, shares or assets constitute capital and are not subject to income or excess profits tax. Such proceeds will likewise not be subject to tax in the hands of members of associations of persons or shareholders of corporations upon the winding up of, or upon a reduction of capital of, the association or corporation.

The above is subject to the following exceptions, namely:

If any association of persons or a corporation acquires a mining property or an interest therein by staking or purchase, or by purchase of units or shares, and instead of bona fide prospecting or developing they are in fact conducting a business of trading therein or are conducting a campaign to sell shares or units to the public at large by advertising or otherwise under the cloak of engaging in prospecting and development, then they shall not be eligible for relief under the foregoing. Nothing in this paragraph, however, shall be taken to mean that legitimate advertising may not be used to raise funds for bona fide prospecting and development. *(Issued March 1941)*

GENERAL NOTES

Matters of Interest to Members

The Executive Committee of The Dominion Association of Chartered Accountants held its mid-year meeting in Toronto on 28th February and 1st March with a full attendance of members, namely, W. G. Rowe, Vancouver, President; Kenneth W. Dalglish, Montreal, Immediate Past President; Frederick Johnson, Winnipeg, and T. Harold Johnson, Halifax, Vice-Presidents; Kris A. Mapp, Toronto; Malcolm C. McCannel, Edmonton; Henry G. Norman, Montreal; and Austin H. Carr, Secretary-Treasurer.

Death of Two Former Presidents—Since the last annual meeting of the Association, two former Presidents have passed away in the persons of James D. Sutherland, F.C.A., and John MacKay, F.C.A. In the January and February issues of THE CANADIAN CHARTERED ACCOUNTANT tribute was paid to the life and work of these distinguished members of our profession in Canada. It was decided that the tribute to Mr. Sutherland on page 6 of the January issue and that to Mr. MacKay on page 91 of the February issue form part of the minutes of the Executive Committee.

December 1940 Examinations—Gerald Jephcott, Chairman of the Committee on Education and Examinations of the Provincial Institutes, was invited to make a report on the uniform examinations of December 1940. As his Committee had not met since the holding of these examinations, Mr. Jephcott explained that his report would be an unofficial one. As part of his report he included the memorandum of the Board of Examiners-in-Chief showing the result of the Intermediate and Final examinations by provinces, also a financial report which indicated that the finances of his Committee were in satisfactory condition. As the Executive Committee of the Association had been much interested in the adoption and the effective carrying out of uniform examinations, the members offered suggestions towards still greater progress, and thanked Mr. Jephcott for his report. The Secretary reported that all nine Institutes were in favour of the suggestion of the Executive Committee that a mid-year Final examination be held this year about the first of June.

Reciprocity of Entrance Fees—Following the last annual meeting and the publication of the Year Book, which gave a comprehensive report of the proceedings of the last annual meeting, the Secretary-Treasurer sent to the secretaries of all the Provincial Institutes a copy of the report of the Executive Committee made to that meeting on the subject of Reciprocity of Entrance Fees, together with particulars concerning replies received last year from the Institutes on this subject. In those replies four Institutes had signified a desire for reciprocity, and the annual meeting expressed the hope that these would be able to find common ground and that in time all Institutes would arrange measures of reciprocity.

Since that time the Institutes of Alberta, British Columbia, Manitoba and Quebec have either amended their by-laws or are contemplating making the necessary changes therein for bringing reciprocity into effect.

The Executive Committee decided that no further action by the Dominion Association respecting this matter was needed except to keep the other Institutes advised of any progress which might be reported from time to time by any Institute.

Amendments of By-Laws—The 1940 annual meeting of the Association went on record as approving a rebate of dues to any constituent Institute of any member whose dues had been rebated by the Institute on account of serving in His Majesty's Forces, and it instructed the Council to take action to amend the Association's by-laws to that end.

As such proposed amendment was designed to meet a situation arising out of present war conditions, the Executive Committee felt that it should appear as a sub-section to present by-law 6, which could be dropped after serving its purpose. Mr. T. Harold Johnson was appointed a committee of one to draft the necessary amendments for submission to the 1941 annual meeting.

Students and Military Training—The Secretary reported that an enquiry had been received from one Institute as to whether or not further representation was being made by the Association to the Dominion Government for exemption from military training of students in chartered accountants' offices.

The Executive Committee was unanimous in the opinion that, in view of the Institutes having applied for and having been granted postponement of the period of military training for students to the summer of 1941, no further postponement should be sought. Accordingly, the Secretary-Treasurer was asked to convey this information to the constituent Institutes.

Legislation—Following the enactment last August of *The Excess Profits Tax Act, 1940,* considerable correspondence had been received from members over its provisions. Copies of all these letters were sent to the Legislation Committee and received its careful consideration. Mr. Norman, Chairman of the Committee, reported that on 21st November 1940 his Committee had sent to the Minister of National Revenue a memorandum on (a) Inequities arising from the use of fiscal years as distinguished from calendar years for the establishment of standard profits, and (b) Businesses whose operations entail the using up of their assets represented by assets subject to exhaustion.

Since then the Legislation Committee made further studies and prepared a second memorandum for submission to the Government. After careful study of its details by the Executive Committee, the memorandum was approved for submission to the Minister of National Revenue.

Tax Information—The Secretary reported that the members of the profession were being kept up-to-date on tax amendments and on other matters helpful in their daily practice. Since the annual meeting four instalments of information had been sent to them—on 4th and 20th December, 29th January and 17th February. Included in this information were amendments of taxation acts, summaries of judgments of the Exchequer Court and the Supreme Court of Canada respecting income tax, rulings of general application issued by the Income Tax Division and regulations of the Foreign Exchange Control Board. The reference libraries of the Institutes, he stated, had also received copies of full judgments in tax cases and the text of the amendments of tax statutes.

Finances—The Chairman of the Finance Committee, Mr. Mapp, presented a report of the estimated revenue and expenditure of the Association for the year ending 31st May

1941. This showed the finances to be in a satisfactory condition.

The Canadian Chartered Accountant—The Secretary reported that the circulation of THE CANADIAN CHARTERED ACCOUNTANT continued to increase in spite of the change in the annual subscription price from $2.00 to $3.00. The circulation for January 1941 was 4140, and of this 711 were general subscribers. Reference was made to the generous offer of the Alberta Institute and the Quebec Society to pay $25.00 to any member (including students in the case of the Quebec Society) who prepared an article acceptable to the Editorial Committee for publication in the Magazine. Reference was also made to the series of instructive articles by the late Professor McQueen published during the past eighteen months.

The Executive Committee expressed gratification over the progress of the Magazine of our profession and expressed thanks to Mr. W. J. Saunders, the Chairman of the Editorial Committee, and to all those who were associated with him in its publication.

Annual Meeting—According to the by-laws, the 1941 annual meeting of the Association is to be held in British Columbia. The local arrangements are being made by the British Columbia Institute, and the third week in August was suggested by the Executive Committee. It was unanimously recommended that a half day of this year's annual meeting be given over to the discussion of taxation and that a few members be asked to come prepared to discuss the subject. It was also decided that a dinner be held this year for male members only at which there would be a prominent speaker.

Entertainment—At noon on Friday the members of the Committee were guests of W. G. H. Jephcott, President of the Ontario Institute, at luncheon at the National Club, also of the Council of the Institute at its mid-year dinner at the Royal York Hotel on Friday evening. While the members individually had expressed thanks to their hosts, the Secretary was asked to place on the minutes this record of the appreciation of the Committee and to convey its thanks in a letter to Mr. Jephcott.

Our Contributors This Month

The editorial committee welcomes as one of the contributors this month, a student of the Quebec Society—Alan W. Bell. Mr. Bell is a graduate of the University of Alberta (B.Com. 1937) and of the Harvard Graduate School of Business Administration having received his degree of Master in Business Administration in 1940. He is now in training in the office of P. S. Ross & Sons, Montreal.

The other contributors need no introduction to our readers.

Mid-Year Final Examination

The Board of Examiners-in-Chief of the Provincial Institutes of Chartered Accountants announces the holding of a mid-year Final examination in 1941 during the week of June 2nd to 7th. This examination does not replace the annual one which will be held in December next. The hours of writing are from 9 a.m. to 1 p.m. on the following days:

1941	*Subject*
Monday, 2nd June	Auditing I
Tuesday, 3rd June	Auditing II
Wednesday, 4th June	Accounting I—Accounting, including business investigations
Thursday, 5th June	Accounting II—Accounting including costs, budgetary control and systematizing
Friday, 6th June	Accounting III — Accounting, including consolidations, executorships and trusteeships
Saturday, 7th June	Accounting IV—Accounting, General

More Chartered Accountants Needed

During the past month we have received several requests for chartered accountants. Some of these positions are described on page iii of this issue. F. E. Wood, Chief of the Cost Accounting Section of the Department of the Treasury at Ottawa, is calling for more men and at our request has kindly prepared a memorandum which appears elsewhere in this issue. C. P. White, Internal Auditor of the British Purchasing Commission, also wants men, and we welcome the opportunity of also bringing his needs to the attention of members.

The Nonchalance of the Young Britishers

The following is an extract from a letter dated 2nd February 1941 received by one of our Toronto members from his young niece in Eastbourne, Sussex, England. "Home," mentioned in the letter, was nearly four miles away.

> On Sunday Mother and I had a lovely tramp with the two dogs over the Downs to Friston. There had been a week of frost and we discovered that the ice on the pond was just right for skating so we hurried home and coaxed Daddy to leave his work and we went out to the pond again that night. It was one of those nights one never forgets, very still and frosty with a full moon. The German planes were very busy and I don't think I've ever had such a sensation of melodrama since war was declared, much more so than when the danger is closer. The planes were so low we could distinctly see their silhouettes against the clear night sky. They came in from the sea and up the Cuckmere and then circled overhead. I think they were looking for the waterworks. There were so many explosions two or three miles away and the roar and flash of the barrage, yet we seemed to be in a little charmed circle on ice, skating in silence in a pool of moonlight.

For our readers who are not familiar with this part of England, it may be added that the "little charmed circle" mentioned in the letter refers to one of the dewponds which are so characteristic of the Sussex downs. These small shallow circular ponds are to be found usually on the summits of the highest hills and are fed by the rains and by the heavy mists and fogs which sweep in from the sea. Even in an extremely dry summer they are never empty, and without them sheep-farming on the downs would be almost impossible. Kipling refers to them in his poem *Sussex:*

> We have no waters to delight
> Our broad and brookless vales,
> Only the dewpond on the height
> Unfed, that never fails
> Whereby no tattered herbage tells
> Which way the season flies—
> Only our close-bit thyme that smells
> Like dawn in Paradise.

Table of Exchange Rates

(Kindly supplied by The Canadian Bank of Commerce, Toronto)

	28th February 1941	*15th March 1941*
U.S. Dollars	10-11% P.	10-11% P.
Sterling	443-447	443-447
Australian Pounds	358½	358½
New Zealand Pounds	360	360
South African Pounds	446	449
British West Indian—Dollars	9270	9270
India—Rupees	3376	3376
Hongkong—Dollars	2735	2720
Straits Settlements—Dollars	5251	5251
Finland—Finmarks	199	199
Sweden—Kronor	2637	2637
Switzerland—Francs	2568	2567

There are no quotations for Italy (lire) or for the following countries under the control of Germany: Belgium (belgas), Denmark (kroner), France (francs), Holland (florins), and Norway (kroner).

Note: The above quotations are expressed as follows: Pound currencies—Canadian cents per unit; Continental currencies and sundry British Empire—Canadian cents per 100 units.

PROVINCIAL NEWS

ONTARIO

The annual mid-winter dinner and reception to new members of the Ontario Institute was held at the Royal York Hotel, Toronto, on Friday, 28th February and was attended by over 350 members, students and guests. W. G. H. Jephcott, F.C.A., President, occupied the chair. The chief speaker of the evening was C. Fraser Elliott, K.C., Commissioner of Income Tax, whose address, "Taxes and Related Matters" appears elsewhere in this issue.

Mr. Elliott was introduced to the gathering by Fred C. Hurst, F.C.A., Second Vice-President. James F. Duncan, President, Toronto Board of Trade, expressed thanks to the speaker for his interesting address.

The Institute was honoured in having as its guests: Dr. Fred J. Conboy, Mayor of the City of Toronto; W. G. Rowe of Vancouver, President of The Dominion Association of Chartered Accountants; Lieut.-Commander A. C. Turner, Chief Naval Officer, Toronto District; T. Harold Johnson of

Halifax, one of the Vice-Presidents of the Dominion Association; A. Roy Courtice, President, The Canadian Club; Harold Crabtree of Montreal, President, Canadian Manufacturers' Association; Kenneth W. Dalglish of Montreal, Past President, The Dominion Association of Chartered Accountants and a member of the Board of Referees under *The Excess Profits Tax Act;* Kris A. Mapp, member of Executive Committee of the Dominion Association; F. Hedley Marsh, Senior Vice-President, The Canadian Bankers Association; Gordon Bongard, President, The Toronto Stock Exchange; Henry G. Norman of Montreal, President, The Society of Chartered Accountants of the Province of Quebec; Hugh D. Paterson, Inspector of Income Tax, Toronto; Frederick Johnson of Winnipeg, one of the Vice-Presidents of the Dominion Association; Professor W. S. Ferguson, representing The University of Toronto; Professor R. G. H. Smails, representing Queen's University; C. Percy Fell, member of the Board of Referees under *The Excess Profits Tax Act;* Clarence V. Charters, General Manager of the Canadian Weekly Newspapers Association; M. C. McCannel of Edmonton, member of Executive Committee of the Dominion Association; A. H. Carr, Secretary-Treasurer, The Dominion Association of Chartered Accountants; Alex Hutchison and F. J. Graham, both of the Income Tax Department, Toronto.

During the evening the year's graduating class was welcomed into membership in the Institute and the various prizes presented to those who had passed their examinations with distinction.

QUEBEC

A most successful dinner, attended by approximately two hundred and fifty members and guests, was held by the Society of Chartered Accountants of the Province of Quebec in the Mount Royal Hotel, Montreal, on Monday, 10th March 1941. Twenty new members, successful candidates in the recent final examinations, were welcomed into the Society and presented with their diplomas by the President, Mr. H. G. Norman, Chairman of the evening. Mr. Norman's address to the new members appears elsewhere in this issue. War Memorial Prizes for obtaining the highest marks in the Final Examinations were presented to P. M. McEntyre

and Edmond Lemieux; Philip Madras and J. G. Schwartz, who tied for the highest marks in the Intermediate Examination, were also presented with prizes. Mr. Alfred Smibert, Second Vice-President, proposed the toast to the guests, and Mr. Jackson Dodds, General Manager of the Bank of Montreal, responded. Mr. Maurice Peloubet, Vice-President of the American Institute of Accountants, New York, extended the greetings of that body.

The guest of honour, the Honourable T. Damien Bouchard, Minister of Roads and Public Works, Province of Quebec, addressed the meeting on the subject of "Democracy and Public Finances." The appreciation of the meeting was expressed by Mr. Norman.

Those seated at the head table, in addition to Mr. Bouchard, Mr. Norman and Mr. Peloubet, included: D. C. Abbott, K.C., of Phelan, Fleet, Robertson & Abbott; Raymond Allan, Chairman, Montreal Stock Exchange; Alex. Ballantyne, Past President, The Society of Chartered Accountants of the Province of Quebec; Dr. E. F. Beach, Acting-Director, School of Commerce, McGill University; T. V. Burke, President, The Chartered Accountants Students' Society of the Province of Quebec; L. N. Buzzell, of McDonald, Currie & Co.; Wm. H. Campbell, First Vice-President, The Society of Chartered Accountants of the Province of Quebec; H. D. Clapperton, Past President, The Society of Chartered Accountants of the Province of Quebec; L. Cushing, Past President, The Society of Chartered Accountants of the Province of Quebec; K. W. Dalglish, Board of Referees, Excess Profits Tax Act, and Immediate Past President of The Dominion Association of Chartered Accountants; Jackson Dodds, O.B.E., General Manager, Bank of Montreal; C. F. Elderkin, Hon. Secretary-Treasurer, The Society of Chartered Accountants of the Province of Quebec; Francis Fauteux, K.C., Bâtonnier of the Bar of Montreal; E. P. Flintoft, K.C., General Counsel, Canadian Pacific Railway; Valmore Gratton, President, Chambre de Commerce; G. E. Gravel, Chairman, Catholic School Commission; Gordon Hyde, K.C., M.L.A., of Hyde, Ahern & Smith; W. G. H. Jephcott, President, The Institute of Chartered Accountants of Ontario, Chairman, Committee on Education and Examinations of the Provincial Institutes of Chartered Accountants; Kris A. Mapp, Chairman, Finance Committee, Dominion Association of Chartered Account-

ants; Abbé Maurault, Rector, University of Montreal; G. C. McDonald, Past President, The Society of Chartered Accountants of the Province of Quebec and of the Dominion Association; Colonel McRobie, Chairman, Montreal Protestant Central School Board; Esdras Minville, Dean, The School of Higher Commercial Studies; René Morin, Vice-President, The Canadian Chamber of Commerce; Adhemar Raynault, Mayor, City of Montreal; A. F. C. Ross, of P. S. Ross & Sons and a former President of the Dominion Association; D. L. Ross, Chairman, Social Committee; A. H. Rowland, Inspector of Income Tax; C. T. Russell, President, Junior Board of Trade; G. H. Shink, Comptroller of Provincial Revenue; Alfred Smibert, Second Vice-President, The Society of Chartered Accountants of the Province of Quebec; J. A. Towner, President, The Quebec City Committee, The Society of Chartered Accountants of the Province of Quebec; Arthur B. Wood, President, Sun Life Assurance Company of Canada.

OBITUARY

The Late Alvyn A. Graham

The Society of Chartered Accountants of the Province of Quebec reports with deep regret the death on 13th March of one of its young members, Alvyn A. Graham, in his thirtieth year.

Mr. Graham received his Certificate of Membership in the Quebec Society on 13th March 1940 and died exactly one year from that date. He served his apprenticeship with the firms of McDonald, Currie & Co., and Campbell, Glendinning & Co., and after passing his final examination, wished to help in the war effort and accepted a position with the Canadian Associated Aircraft, where he was employed until the time of his death.

To his widow and family the Council and members of the Society extend their sincere sympathy.

BOOK REVIEW

A DIGEST OF INCOME TAX CASES

of the British Commonwealth of Nations and Principal Divisions Thereof

By Molyneux L. Gordon, K.C.

(Volume I, published by *The King's Printer*, Ottawa, 1939, cloth, 1947 pages; Volume II, published by *Age Publications, Limited*, Toronto, 1940, cloth, 434 pages.)

This digest was published by direction of the Hon. J. L. Ilsley, Minister of National Revenue and, as the title implies, is a compilation of synopses of income tax cases which have been heard in the courts of the British Commonwealth over a period of years ending with the year 1939.

The digest is in two volumes in which the cases are arranged chronologically under headings indicating the nature of the principal points involved. An alphabetical list of the cases and a complete subject index are also provided. The first volume, which was published in 1939 and covers a number of years ending with the year 1936, has an appendix which contains extracts from the taxing statutes of the various governments of the Commonwealth and copies of the regulations and certain inter-office instructions (generally referred to as departmental rulings) issued by the Income Tax Department of the Dominion of Canada. The second volume, published in 1940, covers the years 1937 to 1939.

In the preface to the first volume the author states that it is the desire of the Commissioner of Income Tax for the Dominion of Canada to establish, through greater understanding, an ever better relationship between the Government administrators and the tax paying public and that with this in view the Government accepted the compilation and caused its publication. The second volume contains the following foreword by the Commissioner of Income Tax:

> "The approved purpose of the original Digest of Income Tax Cases was to assist taxpayers and their professional advisers and thereby to create through greater understanding a better relationship between the Government administrators and the tax paying public.
>
> "We are pleased to note that the Author intends to keep the work up to date through annual Digests of Income Tax Cases."

It is to be hoped that further issues of the Digest, bringing the work up to date, will be made from time to time and that the Income Tax Department of the Dominion of Canada will permit the regular publication of inter-office instructions or rulings in addition to the regulations which are issued under and by virtue of Section 75, Subsection 2 of the *Income War Tax Act.*

The Digest should serve as an extremely useful book of reference for taxpayers and their advisers seeking information as to the proper interpretation of income tax statutes.

Montreal, 5th March 1941.

FRANK E. H. GATES.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

The problem of instalment distributions on dissolution of partnership is one commonly treated in accounting texts but for some reason rarely encountered on examination papers in spite of its theoretical interest. The trustee's concern is of course to so distribute from time to time the money available for satisfaction of partners' equities that he will not, in any circumstance, find that he has paid to a partner more than that partner's share as finally determined. If the partners' capitals at the date of dissolution stand in the ratio in which they share profits and losses the trustee has merely to make his interim distributions in that same ratio. But if the capital ratios differ from the profit ratios he cannot safely distribute in either the capital ratio or the profit ratio. Suppose A, B and C are in partnership sharing profits in the ratio 5:3:2 with equal capitals of $10,000 each and that on dissolution the trustee (after payment of creditors) has $9,000 available for interim distribution amongst the partners and three months later he has $6,000 available as a final payment. If he were to distribute the $9,000 in proportion to capitals each partner would receive $3,000; if in the profit ratio they would receive: A (½) $4,500; B (3/10) $2,700; C (1/5) $1,800. But the total amount eventually realized is only $15,000 and therefore there is a loss on realization of $15,000 and this loss has to be borne by the partners in the profit ratio so that the total amount to which each is entitled on liquidation would be computed:

		A		B		C
Capital at dissolution ..		$10,000		$10,000		$10,000
Less Loss on realization	(½)	7,500	(3/10)	4,500	(1/5)	3,000
		$ 2,500		$ 5,500		$ 7,000

Clearly if the trustee makes the interim distribution in either the capital or profit ratio he will find himself in the position of having overpaid A and of being personally liable to B and C for the amount overpaid—$500 in the one case, $2,000 in the other. The rule for the trustee to follow in this dilemma is to assume at the date of each interim distribution (a) that it is the final dissolution in the sense

that the remaining assets will realize nothing and (b) that all partners are insolvent in their separate estates. His calculation for the distribution of the $9,000 in the example given would then be as follows:

		A		B		C
Capital at dissolution ..		$10,000		$10,000		$10,000
Less Share of loss ($21,000) on assumption that no more than $9,000 will be realized	(½)	10,500	(3/10)	6,300	(1/5)	4,200
		— 500		3,700		5,800
Less Share of A's deficit (ignoring the rule in Garner v. Murray) ..		+ 500		— 300		— 200
Interim distribution ...		Nil		$ 3,400		$ 5,600

The distribution of the final dividend of $6,000 three months later would be computed in the same way:

Capital at dissolution	$10,000	$10,000	$10,000
Less Share of final ascertained loss ($15,000)	7,500	4,500	3,000
	2,500	5,500	7,000
Less Interim distribution..	Nil	3,400	5,600
Final distribution	$2,500	$2,100	$1,400

The rule for the calculation is easily memorized but the solution of the problem gains in interest if it is realized that the purpose and effect of that rule is to reduce the partners' capitals to the profit ratio as rapidly as possible. Thus in the illustration C's capital is more in excess of his profit ratio than any other partner, B's is next and A's is last. Money available must therefore first be applied to reducing C's capital until it stands in the same ratio to B's capital as C's share of profits is to B's share of profits. This means the reduction of C's capital to $6,667 by payment of the first $3,333 to C. B and C then have combined capitals amounting to $16,667 whereas their combined share of profit is one half and A's equity is only $10,000. Their equities relative to A's equity are therefore in excess by $6,667 so the next $6,667 realized must go to B and C in the profit ratio. The equities of all partners will then stand in the profit ratio and anything realized in excess of $10,000 will be divided in that ratio. By this reasoning the distribution appears:

	A	B	C
Interim distribution, $9,000.			
Applied: $3,333 to C	...	...	$3,333
$5,667 to B and C in their mutual profit ratio (3:2)	...	$3,400	2,267
Totals	...	$3,400	$5,600
Final distribution, $6,000.			
Applied: $1,000 to B and C in their mutual profit ratio (3:2)	...	600	400
$5,000 to A, B and C. in the profit ratio (5:3:2)	$2,500	1,500	1,000
	$2,500	$2,100	$1,400

* * *

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

FINAL EXAMINATION, DECEMBER, 1940
ACCOUNTING I.

Question 1. (25 marks)

The various companies in a certain highly competitive industry agree to adopt a uniform method of costing in the hope of eliminating wasteful price competition caused by widely varying cost methods now in use. You are retained to investigate the manufacturing operations and recommend the method to be adopted. The industry includes young and old companies, with varying financial structures, and is subject to seasonal inactivity.

A satisfactory plan for dealing with material and labour costs has been reached. What other points should be taken into account and how should these points be treated in laying down the cost method for the purposes above described?

SOLUTION

In order to determine selling price it is necessary to consider not only total factory cost but also other expenses which must be met from the proceeds of sales. The methods of dealing with material and labour costs having been satisfactorily determined, there remains the treatment of other elements comprising the selling price, namely—

(1) Factory overhead
(2) Selling and administrative expenses
(3) Return on capital.

Factory Overhead—The first step in obtaining uniform costs is to ascertain that factory overhead is being dealt with on a uniform, intelligent basis. This will require particular attention being paid to items not necessarily common to each plant, e.g.,

Depreciation—Some companies' plants may be fully depreciated on their books. To obtain uniformity it would be necessary for these companies to charge into costs a normal provision for depreciation even though it were necessary to reverse it at the end of the year in their financial statements. On the other hand some plants may have been erected at a time of relatively high or low prices so that depreciation charges on a cost basis would be abnormal; or some plants may be so obsolete and relatively inefficient that depreciation based on their cost would be unwarranted. If such were the case it might be desirable to have an appraisal made of all plants and for cost purposes determine depreciation at uniform rates applied on appraised values.

Rent—If some companies lease rather than own factory premises, consideration will have to be given to see that the rent paid is not out of line with what the corresponding charges would be if the company owned its own building. (That is, depreciation, taxes, repairs, interest on investment). The rental charges may be abnormally high or low if, for instance, a long-term lease had been entered into many years ago, or if the buildings were owned by the company's shareholders. In such cases the rental included in costs should be adjusted to a basis comparable with charges absorbed by other companies.

Having obtained a uniform basis for determining total factory overhead of each plant, it is then necessary to relate this charge to volume of production. The type of product manufactured will probably indicate the best basis to be followed, e.g. proportionately to direct labour cost or hours or possibly by a more complicated method involving production centres. The basis chosen, however, must be such as will avoid possible variations arising from slack and busy periods. If the full year is adopted as a basis for study, then based upon estimated production and past experience, the overhead charges can be evenly related to production. All companies will not, of course, apply the same rate for factory overhead as their costs will not be the same, but the variation between rates should represent an actual variation in cost of production.

Selling and Administrative Expenses—These expenses can probably best be dealt with in each company by determining rates which, when applied to total factory cost, will prove sufficient to absorb the estimated expenses for the year. As in the case of factory costs, it is necessary to be sure that the expenses are being dealt with on a uniform intelligent basis. Particular care will have to be given to the executive remuneration. In the case of some privately-owned companies, it may be that the salaries of proprietors are either very much larger or very much less than those of publicly-owned companies. In such cases the allowance for selling and administrative expenses should be adjusted to what might be considered a normal salary having regard to the size of the business and the responsibilities assumed by the owners.

Interest on Investment—The different methods of capitalization of the different companies will require consideration. Some companies

may have funded debt or heavy bank interest charges which they will seek to include as expenses. In order to obtain uniformity it would be advisable to eliminate debt charges from the calculations of all companies (except for interest on seasonal bank loans) and instead to substitute a charge to provide a nominal return upon the capital employed. In such case the capital employed would be measured as the sum of the net worth and funded debt and adjusted by the eliminating of intangible assets and making allowance for any variations between appraised and book values of fixed assets.

Profits—The question does not suggest that uniform selling prices are to be established or that there is to be any compulsion upon the members of the industry. It is hoped that as a result of calculating costs in a uniform manner the competition will become more intelligent. The costs arrived at on the basis indicated above will not be the same for the same product in each company—the more efficient companies will presumably show a lower cost than the less efficient. The amount of profit to be added in making quotations should be left in the absolute discretion of the management of each company and it is clearly undesirable to even suggest the establishment of a uniform method of determining profit for the purpose of reaching uniform price quotations. Apart from ordinary business considerations, carrying uniformity to such lengths might possibly constitute a breach of the combines legislation of the Dominion.

PROBLEM II

THE PROVINCIAL INSTITUTE OF CHARTERED ACCOUNTANTS

FINAL EXAMINATION, DECEMBER, 1940
ACCOUNTING III

Question 4 (35 marks)

Following are the trial balances of Co. A and subsidiaries as at 31st December 1939:—

Debits	Company A	Company B	Company C
Inventory, 1st January 1939	60,000	70,000	25,000
Cash	$ 15,000	$ 7,500	$ 22,500
Accounts receivable	50,350	40,000	70,000
Current accounts—Company B	10,000		
—Company C		5,000	
Plant and Machinery	150,000	50,000	50,000
Investment in Company B—90%	156,250		
Company C—80%	86,400		
Bonds of Company C		40,000	
Purchases—Raw materials	140,000	90,000	65,000
Manufacturing costs	100,000	60,000	40,000
Selling expenses	20,000	17,000	10,000
Administration expenses	10,000	10,000	8,000
Bond interest paid	10,000		2,500
Dividends paid	10,000	7,500	4,500
	$818,000	$397,000	$297,500

Credits			
Share capital	$200,000	$125,000	$ 75,000
Surplus, 1st January 1939	40,000	45,000	25,000
Bonds payable	200,000		50,000
Depreciation reserve	45,000	5,000	5,000
Accounts payable	13,000	10,000	10,000
Current account—Company A		10,000	
—Company B			2,500
Sales	320,000	200,000	130,000
Bond interest from Company C		2,000	
	$818,000	$397,000	$297,500

Further information:—

Company A purchased its interest in Company B on 1st January 1937 and in Company C on 1st January 1939. All subsidiary earnings and dividends have been recorded by Company A through the investment account prior to 1st January 1939. During the year, the holding company has taken up the dividends by credits to investment accounts, but has not taken up the subsidiary profits for the year.

	Company A	Company B	Company C
Inventories, 31st December 1939	$ 70,000	$ 65,000	$ 30,000

Inventories as at 1st January 1939 contained inter-company profits made by sales between companies as follows:—

	Profit made by Company B	Profit made by Company C
Company A's inventories	$ 2,000	$ 3,000
Company B's inventories		2,000
Inventories as at 31st December 1939 contained profits as follows:—		
Company A's inventories	4,000	4,000
Company B's inventories		3,000

Company C sold $50,000 in goods to Company B during year and $20,000 to Company A; Company B sold $40,000 to Company A.

Company B sold plant and machinery to Company A on 1st January 1939 for $25,000, on which Company B made a profit of $2,000.

Company C issued a cheque on 31st December to Company B of $2,500.

Provide depreciation on plant and machinery at 10%.

Prepare: (A) Consolidated working papers.

(B) Consolidated balance sheet as at 31st December 1939.

(A)

SOLUTION

COMPANIES A, B AND C

CONSOLIDATED WORKING PAPERS 31st DECEMBER 1939

Debits	*Company A*	*Company B*	*Company C*	*Adjustments Dr.*	*Adjustments Cr.*	*Eliminations*	*Cost of Sales*	*Profit & Loss*	*Balance Sheet*
Cash	$ 15,000	$ 7,500	$ 22,500	$ 2,500					$ 47,500
Accounts receivable	50,350	40,000	70,000						160,350
Inventories	60,000	70,000	25,000		$ 1,800		$153,200		
Current accounts Co. B	10,000					$ 10,000			
Co. C		5,000			2,500	2,500			
Plant and machinery	150,000	50,000	50,000						250,000
Investment in Co. B—90%	156,250								
Eliminate book value at 1st January 1939 less year's dividends out of 1st January Surplus									
Capital 90%—$125,000						112,500			
Surplus 90%— 37,500						33,750			10,000 G.
Investment in Co. C—80%	86,400								
Eliminate book value at 1st January 1939 less year's dividends out of 1st January Surplus									
Capital 80%—$75,000						60,000			
Surplus 80%— 20,500						16,400			10,000 G.

Bonds—Co. C		40,000							40,000
Purchases raw materials	140,000	90,000	65,000			110,000	185,000		
Manufacturing costs	100,000	60,000	40,000				200,000		
Selling expenses	20,000	17,000	10,000					$ 47,000	
Administrative expenses	10,000	10,000	8,000					28,000	
Bond interest paid	10,000		2,500			2,000		10,500	
Dividends paid A	10,000								10,000 S.
B		7,500			7,500				
C			4,500		4,500				
	$818,000	$397,000	$297,500						
Inventories 31st December 1939				165,000					165,000
Depreciation	$ 14,820	$ 5,000	$ 5,000	24,820				24,820	
Reserve for inter-company profit on machinery sold				1,800					1,800 S.
Total debits to nominal accounts including depreciation	$354,820	$252,000	$155,500						
				$194,120	$ 16,300	$347,150			
Total debits to cost of sales							$538,200		
Less Credits to cost of sales—per contra							155,800		
Cost of goods sold—to Profit & Loss							$382,400	382,400	
Total debits to Profit & Loss—deducted contra								$492,720	
									$694,650

(A)—continued

COMPANIES A, B AND C

CONSOLIDATED WORKING PAPERS 31st DECEMBER 1939

Credits	*Company A*	*Company B*	*Company C*	*Adjustments Dr.*	*Adjustments Cr.*	*Elimina-tions*	*Cost of Sales*	*Profit & Loss*	*Balance Sheet*
Adjustments brought forward				$194,120	$ 16,300				
Share Capital									
Co. A	$200,000								$200,000
Co. B—Eliminate 90%		$125,000				$112,500			
—Minority 10%									12,500 M.
Co. C—Eliminate 80%			$ 75,000			60,000			
—Minority 20%									15,000 M.
Surplus									
Co. A	40,000								
Adjustment for inter-company profits 1st January				1,800					38,200 S.
Co. B		45,000		7,500					
—Eliminate 90% of $37,500 ..						33,750			
—Minority 10% of $37,500 ...									3,750 M.
Co. C			25,000	4,500					
—Eliminate 80% of $20,500 ..						16,400			
—Minority 20% of $20,500 ...									4,100 M.
Bonds payable	200,000		50,000						250,000
Depreciation reserve	45,000	5,000	5,000		24,820				79,820
Accounts payable	13,000	10,000	10,000						33,000
Current account—Co. A		10,000				10,000			
—Co. B			2,500			2,500			
Sales	320,000	200,000	130,000			110,000		$540,000	
Bond interest from Co. C		2,000				2,000			
	$818,000	$397,000	$297,500						
Inventories 31st December 1939	$ 70,000	$ 65,000	$ 30,000	9,200	165,000		$155,800		

Reserve for inter-company profit on inventories					9,200				9,200 R.
Total credits to nominal accounts ..	$390,000	$267,000	$160,000						
Less debits to nominal accounts	354,820	252,000	155,500						
Net profits of separate companies ...	$ 35,180	$ 15,000	$ 4,500						
Minority interests		$ 1,500	$ 900						
Reserve for inter-company profit on machinery sold					1,800				1,800
				$217,120	$217,120	$347,150			
Total credits to cost of sales deducted contra							$155,800	$540,000	
Total debits to profit and loss—per contra								492,720	
Net profit for year								$ 47,280	
Minority interest in Co. B							$ 1,500		1,500 M.
Minority interest in Co. C							900	2,400	900 M.
Holding company share of net profit								$ 44,880	44,880 S.
									$694,650

(B)

COMPANY A AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET AS AT 31st DECEMBER 1939

Assets

Current			
Cash		$ 47,500	
Accounts receivable		160,350	
Inventories	$165,000		
Less Reserve for inter-company profits	9,200	155,800	$363,650
Fixed			
Plant and machinery		$250,000	
Less Reserve for depreciation	$ 79,820		
Reserve for inter-company profits	1,800	81,620	168,380
Goodwill			20,000
			$552,030

Liabilities

Current		
Accounts payable		$ 33,000
Bonds Payable	$250,000	
Less Treasury bonds	40,000	210,000
Minority Interests		
In Co. B—10%	$ 17,750	
In Co. C.—20%	20,000	37,750
Capital and Surplus		
Share capital	$200,000	
Surplus	71,280	271,280
		$552,030